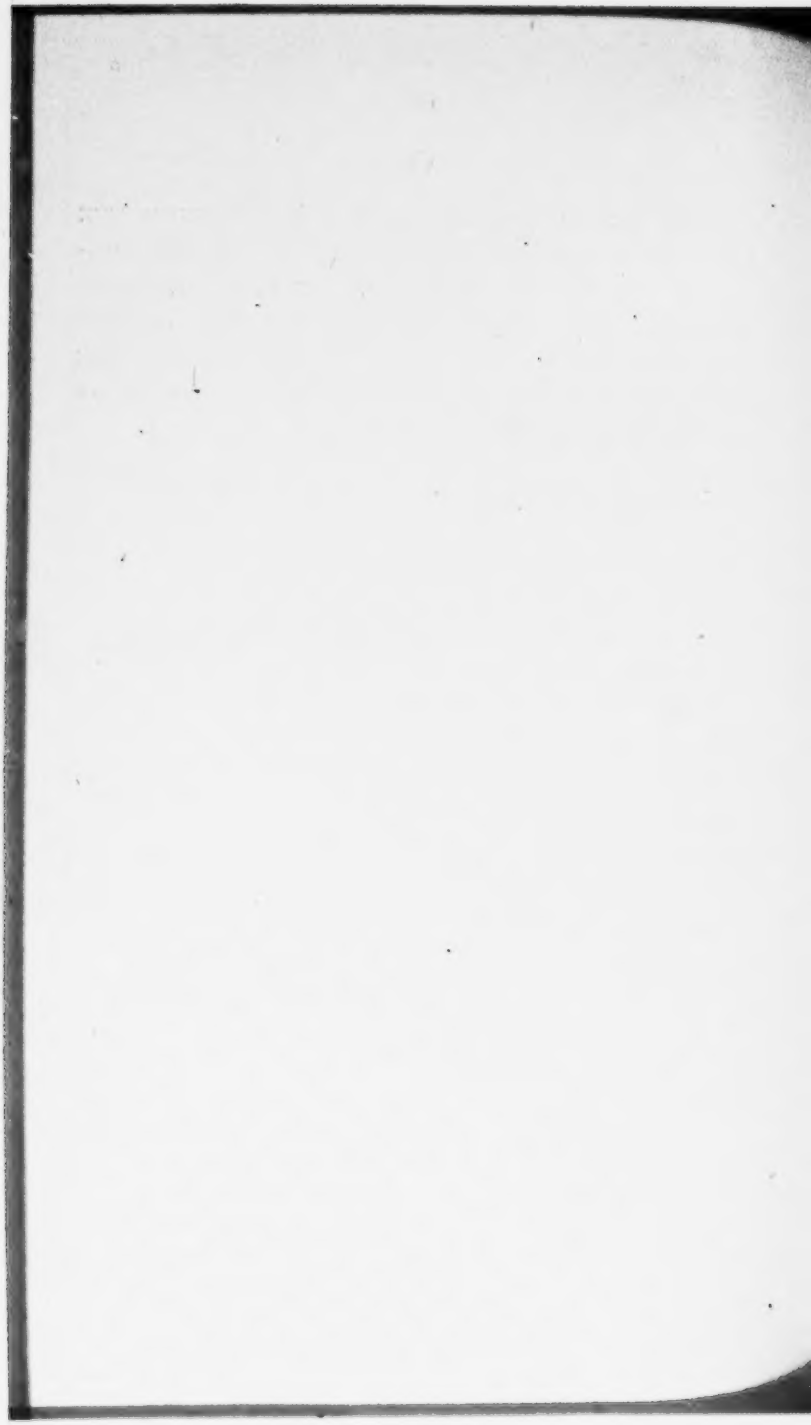

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Supreme Court of the United States

Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

OCTOBER TERM, 1904.

No. 217.

THE GREAT WESTERN MINING AND MANUFACTURING COMPANY, by L. C. BLACK, its Receiver,

Petitioner,

against

CHARLES A. HARRIS *et al*, Executors of B. D. HARRIS, deceased,

Respondents.

BRIEF FOR RESPONDENTS.

JULIEN T. DAVIES,
BRAINARD TOLLES,
Of Counsel.

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BRIEF FOR RESPONDENTS.

This suit in equity was begun in 1895, in the Circuit Court of the United States for the District of Vermont, by L. C. Black, a receiver of all the property and assets of The Great Western Mining and Manufacturing Company, appointed as such by the Circuit Court of the United States for the District of Kentucky (Rec., 1, 7). The suit was brought by the receiver in the name of the corporation under the supposed authority of an order of the Circuit Court for the District of Kentucky (Rec., 7, 366). The object of the suit was to obtain certain relief as set forth in the bill against B. D. Harris, a former director

and stockholder (Rec., 2, 3). B. D. Harris died in 1899, and the suit was revived against his executrix and executors, the present defendants (Rec., 32). The Circuit Court gave judgment against the defendants for $15,000 and costs (Rec., 194). Both parties appealed (Rec., 195, 202), and the Circuit Court of Appeals reversed the judgment in favor of complainant and dismissed the bill (Rec., 401).

The Great Western Mining and Manufacturing Company was incorporated by a special act of the General Assembly of Kentucky, approved January 19, 1856 (Rec., 297). A right was reserved to amend or repeal "for a violation of the rights and powers herein granted"; but it does not appear from the record that such power was ever exercised or that any occasion for its exercise ever arose or that the corporation ever accepted the present Constitution of Kentucky. The law applicable to its corporate affairs is therefore to be found in the act of incorporation and in the general laws of Kentucky in force at the time of its enactment.

Organization and Early History.

The corporation was duly organized in accordance with the charter on July 7th, 1858 (Rec., 297), and one thousand shares of its capital stock were subscribed and paid for (Rec., 299). The authorized capital was three millions of dollars, divided into thirty thousand shares of one hundred dollars each (Rec., 297). The company at once engaged in the business of mining and selling coal at or near Peach Orchard, Ky. (Rec., 299), and was continuously engaged in that business for several years. At some time prior to 1865, the working of the mines was dis-

continued, but it was renewed in 1881, new mines were opened, a railroad was constructed and important improvements were made at an expense of over $100,000 (Rec. 66, 159, 322). The directors' minutes from July 7th, 1858, to May 27th, 1893, are set forth in full in the Record (pages 297 to 364). John Carlisle was a director of the company during its entire existence, and was Secretary from October, 1863, to the end.

In 1863 negotiations took place in respect to a proposed sale of all the stock of the corporation. The transaction was conducted as though it were a corporate transaction, and by a resolution of the Board of Directors passed November 2, 1863, it was provided that "a decision of a majority of the stock as to what is satisfactory security shall be binding upon all" (Rec., 302). On the following day the directors, having obtained a more correct knowledge of the nature of corporate stock, passed a resolution as follows (Rec., 302):

> "*Resolved*, That notwithstanding the resolution of the 2d inst. is that a majority of the stock shall determine the security offered by the buyer; that in the settlement with the buyer each individual stockholder shall use his own pleasure and judgment and that the settlement with the buyer shall be with the owners of the stock respectively, and the stockholders in the aggregate shall not be governed by the individual action of each stockholder."

The proposed sale was not carried into effect, and the property continued to be managed by the original incorporators and their associates until 1883. From time to time additional stock was issued for various reasons and considerations (Rec., 301, 302, 306, 307), until in February, 1874, $245,000 of stock was outstanding (Rec., 309). By resolution adopted April 1, 1874, Messrs. Daniel Mc-

Laren and Stanley Matthews were released from their subscriptions, reducing the stock to $185,000 (Rec., 310). The directors made an attempt to reduce the capital stock still further by calling in all the shares and issuing new certificates for one-third the amount of the old ones (Rec., 311), but the resolution passed to this end was apparently never carried into effect. At a meeting of stockholders held March 25, 1882, a resolution was adopted as follows (Rec., 328):

> "Whereas, the board of directors have passed a resolution recommending that one hundred and fifty shares of paid-up stock of this company be issued and delivered to John Carlisle for his services in taking care of the property for the last seventeen years, which resolution meets the approval of the stockholders; therefore
>
> *Resolved*, By the stockholders of the Great Western Mining and Manufacturing Company, that the directors of said company are hereby authorized and requested to issue and deliver to said John Carlisle one hundred and fifty shares of the capital stock of this company, paid up in full, in consideration for his services rendered the company in caring for the property in the past seventeen years."

At the stockholders' meeting held March 20, 1883, the record shows (R., 330):

> "Mr. Richardson, the superintendent, reported that the mines were now in working order, all the necessary improvements being completed, and that he was shipping 200 tons of coal daily. In order to do a profitable business the working capital should be largely increased, so that more houses could be erected and other mines opened. An output of 1,000 tons daily would increase a net profit to the company of $45,000 per year.
>
> A committee, consisting of the president and secretary, were requested to get the signatures of the stockholders to an agreement to reduce the capital stock one-half, so as to provide by the selling of the relinquished stock sufficient working capital to mine on a large scale."

About this time extensive development work was being

carried forward and improvements made, principally with moneys advanced by John Carlisle (Rec., 331). The minutes of the directors' meeting of August 27, 1883, show (Rec., 334):

> "No reports for July were received, but the June report of mining was read and some disappointment expressed that there was still a loss, which Mr. Carlisle explained was necessary so long as the output of coal was not increased, and that could not be done without a further increase of working capital, and he referred to his report of March, 1882."

The minutes of the meeting of October 22, 1883, show (Rec., 335):

> "Reports of operations of the mines for July, August and September were read. Still losing money. All members of the board except G. W. Carlisle and John Carlisle, declined to advance any more money for working the mines.
>
> The secretary reported that he had been unable to induce any one to discount the note for $7,000, authorized at the last meeting, and that he had been compelled to pay the note due September 17th out of his private funds. No one volunteered to share the burden with the secretary."

B. D. Harris' Connection with the Company.

In the following month John Carlisle succeeded in interesting B. D. Harris and G. D. Harris in this company. The way in which it came about is described by John Carlisle as follows (Rec., 57):

> "The original company was composed of R. B. Bowler, Larz Anderson, George K. Schoenberger, George Carlisle and others. After my father's death (the death of George Carlisle) his interest passed to his two sons; after Mr. Bowler's death his interest was represented by his sons; after the railroad was constructed to Peach Orchard it was found impossible to secure the assent of Mr. Anderson, Mr. Schoenberger and the Bowler heirs to furnish the capital necessary to put the mines in operation except to a limited degree. I had furnished myself the bulk of the cost of putting the mines in condition to

operate, and I had been compelled to become responsible to the gentlemen named before for the moneys that they put up. The majority of the stockholders in 1883 were willing to sell out their stock, and I then induced B. D. Harris and his brother to purchase the stock owned by Larz Anderson, George K. Schoenberger and the Bowler heirs."

And at page 59 of the Record:

"I couldn't state how much they bought except from the records; the amount they paid for it was, I think, $30 a share, but I am not positive."

The stock transfer book shows six hundred shares issued to B. D. Harris, November 18, 1883, and the same amount to G. D. Harris on the same day (Rec., 220). The actual delivery of stock probably took place on November 15, 1883, because on that day Messrs. B. D. Harris, G. D. Harris and James C. Holden were elected directors to fill vacancies. B. D. Harris was elected president. At the same meeting the directors authorized an issue of $60,000 of seven per cent. first mortgage bonds (Rec., 336). At a meeting held April 24, 1884, the president and treasurer were authorized to raise $30,000 by selling or pledging a like amount of said bonds "for the purpose of procuring additional plant and improvements, including mining machines, so as to increase the production of the mines" (Rec., 339).

Of these first mortgage bonds, $21,000 were purchased by B. D. Harris, $1,000 by J. C. Holden, $10,000 by John Carlisle, $15,000 were accepted as collateral for a loan of like amount by the Cheshire Savings Bank, $5,000 were accepted as collateral for a loan by O. C. Phelps, and $8,000 were retained for working capital (Rec., 270, 271).

By the aid of this new money, the working of the mine

became profitable. Net earnings, dividends and interest from 1884 to 1889 inclusive were as follows (Rec., 295, 345 and 209 to 212):

	NET EARNINGS.	INTEREST.	DIVIDENDS.
1884	$8,603.09	.....	
1885.....	4,503.19	$4,612.29	$4,000
1886.....	6,021.81	3,490.00	
1887	21,579.67	3,490.00	
1888.....	30,610.95	6,536.99	4,500
1889 (1st six months).	18,999.98	3,900.00	6,000
	$90,318.69	$22,029.28	$14,500

At least $8,000 of the interest is properly chargeable to construction account. Deducting the remainder, the surplus on July 1, 1889, was $61,789.37.

These are the figures as finally given by John Carlisle, corrected to conform to the directors' minutes in the matter of dividends. During this period B. D. Harris was president of the company. He resided at Brattleboro, Vt. He usually attended the annual meetings of stockholders and the directors' meeting held on the same day; but seldom attended any other meetings. The management of the affairs of the company was practically left to John Carlisle, assisted by the vice-president, Mr. Richardson. At a meeting held May 5, 1887, at which B. D. Harris was present, the record shows (Rec., 343, 344):

> "The vice-president recommended that new mines be opened on Nats Ck., where the coal showed excellently, both in quality and thickness. Upon motion the recommendation was accepted and approved, and the vice-president was directed to open the new mines, the expense of which should be provided for out of the earnings of the company."

At a meeting held November 10, 1887, at which B. D. Harris was present, the record shows (Rec., 344):

"The secretary and treasurer reported that the business at the mines was unusually good, and that owing to the long drouth and the unsurpassed facilities for supplying the markets with Peach Orchard coal by rail from the company's mines, that the profits had largely increased and the only thing lacking was sufficient capital to enable the company to increase the output enough to meet the demands. He also reported that a large amount had been expended this year for permanent improvements out of the earnings of the company, the total for the past three years amounting to over $50,000.

On motion of Mr. G. D. Harris, the president and secretary were authorized to call a meeting of the stockholders on January 11th, at Cincinnati, for the purpose of voting on an increase of the capital stock to the amount of $50,000, to be divided *pro rata* among the stockholders, being the amount of net earnings expended in permanent improvements."

Increase of Stock in 1888.

At the special meeting held pursuant to this resolution, B. D. Harris and G. D. Harris were represented by proxy and the following preamble and resolutions were adopted unanimously, 1990 shares voting (Rec. 344):

"Whereas, there has been expended for permanent improvement and betterments, including barges, flats, opening of new mines, machinery, &c., during the past three years, the amount of $64,666.44, all of which sum has been furnished from the net earnings of this company.

Resolved, that the stockholders being entitled to this amount, the president and secretary are authorized and directed to issue five hundred shares of stock of this company, to be divided *pro rata* among the stockholders of this company as follows:

To B. D. Harris, one hundred and fifty shares.
To G. D. Harris, one hundred and fifty shares.
To John Carlisle, one hundred and ten shares.
To G. W. Carlisle, seventy-five shares.
To George S. Richardson, thirteen shares.
To James C. Holden, one share.
To L. Hinsdale, one share."

At a meeting of the directors held on the same day, stock was directed to be issued accordingly and the directors also voted to begin paying regular quarterly dividends at the rate of three-quarters of one per cent. on the capital stock (Rec., 345).

In accordance with the above-quoted resolution 150 shares of stock were issued to B. D. Harris, Jan. 14, 1888, represented by certificate No. 36 (Rec., 221). All this stock was transferred out of the name of B. D. Harris prior to December 10, 1889 (Rec., 221). Corresponding amounts of stock were issued to all the other stockholders, *pro rata*, according to the terms of the resolution.

Efforts to Obtain Additional Capital.

At a directors' meeting following the annual meeting of stockholders on April 26, 1888, the minutes show (Rec., 347):

> "The president and secretary were appointed a committee to prepare a plan for securing additional capital in order to increase the business of the company."

During the Summer of 1888 John Carlisle entered into negotiations with a man named Vernon in regard to the sale of bonds (Rec., 126, 138). Mr. Vernon prepared a statement "in order to bring it properly before the public" (Rec.,138), and it was in regard to Mr. Vernon's plan, the details of which are not shown in the record, that John Carlisle wrote his letter of August 11, 1888, copied in the record at page 125:

> "Hon. B. D. HARRIS—Dear Sir: As I wrote you from New York, Mr. Vernon and I hurriedly prepared a new statement which he had typewritten and forwarded to me to-day. Mr. Tyler and I went over the statement you sent, together with Mr. Vernon, and made several alterations on the latter. I return herewith both to you for you to

criticise, fix up, and send to Mr. Vernon. You will have them typewritten for us. Mr. Tyler is of the opinion the words 'necessary expenses and outlays' will cover, as he expresses it, 'a multitude of sins' and enable us to use the money received from sale of bonds, that is, what is left over and above paying the debts, and working capital, &c."

It seems probable that in reading or copying this letter an error has occurred and that the word "and" before "working capital" should read "for." Otherwise the sentence is incomplete and the "&c." is meaningless. If John Carlisle meant to say that Mr. Vernon's plan, as formulated by Mr. Tyler, contemplated the appropriation by the stockholders of a part of the proceeds of a sale of bonds, without giving up anything of value therefor, then of course it was essential to the legality of the plan, as against existing creditors, that the amount so to be appropriated should be limited to the surplus earnings available for distribution. Whatever the meaning of the letter may be, the Vernon plan cannot be taken to represent the sentiments of B. D. Harris. He never approved or encouraged it in any way, but, on the contrary, the record shows (page 126, foot): "Mr. Harris, the president of the company, strongly objected to have Mr. Vernon to do anything in relation to the bonds," and at page 138:

"He did prepare such statement, which I sent to Mr. Harris, who did not approve of it."

Later, Mr. Carlisle had conferences with other parties in the east in regard to floating an issue of bonds so as to net the company 60 or 65 cents on the dollar (Rec., 118). These negotiations were without success (Rec., 102, 117, 347). Mr. Harris himself took no part in any of these negotiations (Rec., 112).

Negotiations with Elliott, Johnson & Co.

In February, 1889, John Carlisle took up the question of obtaining a loan on a new issue of bonds, with the president of the Penn Mutual Life Insurance Company, of Philadelphia (Rec., 271). The president of the insurance company, deeming the matter better suited to private investors, introduced him to a member of the firm of Elliott, Johnson & Co., of Wilmington, Delaware, bankers and dealers in investment securities (Rec., 19). The date of the meeting with Elliott, Johnson & Co. must have been subsequent to February 27, 1889 (Rec., 271), and prior to March 16, 1889 (Rec., 254).

Prior to this meeting and as early as January 15, 1889, steps had been taken toward a further increase of capital stock. At a directors' meeting held on that date, at which Mr. Harris was not present, the record shows (Rec., 347):

> "It appearing that the item of construction acc. shows over $150,000 having been paid for improvments and betterments from the net earnings of the company, which amount properly belongs to the stockholders of this company, it was, upon motion of Mr. Hinsdale,
>
> *Resolved*, that the attention of the stockholders, at the next annual meeting, be called to the fact of such appropriation of the net earnings, with the request that they instruct the board what action to take."

The negotiations with Elliott, Johnson & Co., passed through two stages. In the first, John Carlisle sought to enlist their services as brokers for the sale of bonds only. Concerning these early negotiations Mr. Scott testified (Rec., 19, 20, 21):

> "Mr. Carlisle told me of the assets and prospects and financial condition of the Great Western Mining and Manufacturing Company; that it had a mortgage debt of $60,000, if I remember correctly, and some floating debt and that he wanted to raise a considerable larger

sum the balance of the money to be used in the furnishing of additional facilities for mining of coal and extending of their business. * * * The matter attracted us. It seemed to be a property of considerable value, from the data which he gave us, and the coal of good quality with a market considerably larger than their output. * * * He furnished us with many letters from people in the Cincinnati locality who were using the coal, of the tenor that it was a steaming coal of rare quality and that if they could get larger amounts of it they would be glad to do so, showing a market for a very much larger output than the company had at any time it was presented to us."

During this period letters were received from Elliott, Johnson & Co., which, though not encouraging, contained a gleam of hope (Rec., 272). Finally, on April 5, 1889, they wrote (Rec., 236):

"We are disposed to take up your matter and offer your bonds to our customers, and believe if we do so we will succeed in placing them. If we agree to do so providing our expert's examination is satisfactory, will you put the matter in our hands, absolutely, to handle, and take $255,000 less 2½ per cent. for the $300,000 bonds?"

Immediately after receiving this letter Mr. Carlisle came East (Rec., 273). Then began the second stage of the negotiations as described in Mr. Carlisle's letter to B. D. Harris, of April 13, 1889 (Rec., 273):

"In my hurried letter yesterday, I do not know that I made matters plain. It is this: Messrs. Elliott, Johnson & Co., about one year since placed, with the aid of Messrs. Fisk, Hatch & Co., of N. Y., the bonds of the Shawnee Coal Co. of this State, who are mining 2,000 tons per day. The bonds were sold at a discount but were sugared with an even amount of stock—dollar for dollar.

They were confident if we would agree to this that they alone could float the loan. That would mean doubling our stock, to which I strongly objected. At last I agreed, subject to your approval, to increase the capital stock to $350,000 or $400,000 and give $150,000 of stock with the bonds."

Mr. Scott's version of the interview referred to in this letter was as follows (Rec., 20):

"The result of the negotiations was a proposition which we made

to him that we would attempt to dispose of bonds to the amount of three hundred thousand dollars, provided they were accompanied with fifty per cent. or one hundred and fifty thousand dollars worth of stock * * * we stating to Mr. Carlisle that, in our judgment, bonds on a coal company could not be floated among our clients unless accompanied with a stock bonus, and we finally suggested and they agreed to furnish one hundred and fifty thousand dollars of stock with the three hundred thousand dollars of bonds."

On April 17, 1889, Elliott, Johnson & Co., wrote (Rec., 233):

"We have not been able to interest Hatch & Foote, but feel that we can sell the bonds per Smally and with our connections and are ready to go ahead. We will not assume any responsibility, such as by purchasing or guaranteeing to float them, merely to issue them over our name provided developments are satisfactory."

On the following day, evidently in response to a request for written statement of their proposition, they wrote (Rec., 233):

"We wrote you yesterday, which will cover what you request, but now restate that our plan is to undertake to float your bonds, provided the further examinations, legal and engineering, are favorable, without assuming any responsibility, so that the bonds, with 50 per cent. of the Great Western Mining and Manufacturing Company's capital stock, as a bonus, will net you 85 per cent."

During the progress of these negotiations the reports made to Mr. Harris by John Carlisle were of the most general nature (Rec., 272 to 274). John Carlisle had the negotiations entirely in his own hands (Rec., 112). Mr. Harris himself never met Elliott, Johnson & Co. until the contract for their services as brokers had been made, and then the conversation was of a general nature (Rec., 21). The above-mentioned letters were apparently shown to Mr. Harris when he went west to attend the annual meeting, about April 20, 1889, as is evident from a letter

written to Elliott Johnson & Co. by John Carlisle under date of April 21, 1889 (Rec., 257):

"Mr. B. D. Harris, our president, arrived last night. I read him your letters, and he assents to your propositions with this understanding, that you receive subscriptions for the bonds, but none to be delivered unless all are subscribed for within a certain period. How long should the time be for the receiving of subscriptions? I enclose copy of resolution relating to issue of additional stock."

In response to this Elliott, Johnson & Co. wrote on April 24, 1889 (Rec., 234):

"The utmost we can do is to agree to float the bonds as rapidly as possible, using our best endeavours. We cannot agree to undertake to name a specific time within which we will agree to sell them, neither do we see our way clear to attempt to take subscriptions for them. * * * Neither can we go ahead with advantage until we get the physical report, as we rely in a great measure upon it to make sales. However, in the meantime we will do some talking. Please mail us a definite acceptance of our terms, giving us absolute control of the matter and putting it in such shape as will constitute our authority."

Pursuant to such request John Carlisle wrote on April 27, 1889, as follows (Rec., 258):

"At a meeting of the directors of the Great Western Mining and Manufacturing Company, held on the 22d inst., your proposition embodied in your letter of the 18th inst., undertaking to float the bonds of this company so that the same should net the company 85 per cent. of the par value thereof, providing 50 per cent. of the par value of the bonds in the stock of the company should also be transferred with said bonds; and also provided that the results of further examination are favorable was presented and accepted, and the secretary was directed to notify you of such action of the directors.

This gives you the exclusive authority to negotiate the sale of the bonds of the company."

The minutes of the directors' meeting of April 22d show no such resolution as is mentioned in the above-quoted letter, but do show the following (Rec., 351):

"Resolved, that the president and secretary of the company shall

arrange for the sale of the three hundred (300) bonds aforesaid, in their discretion at the best price obtainable; and the proceeds thereof shall be applied to the cancellation and retirement of sixty (60) first mortgage seven per cent. bonds, dated January 1, 1884, now outstanding; also to the payment of all floating indebtedness incurred up to date hereof, for material and construction; and the balance shall be used by the directors for the best interest of the company."

From this it is evident that John Carlisle, at the time of writing his letter of April 27, 1889, had no authority to give away stock belonging to the stockholders, individually, or to bind the company or the stockholders by any representations of fact. He was merely one member of a committee empowered to sell bonds at the best price obtainable.

In a private letter to Mr. Scott accompanying the above-quoted letter of April 27, he said (Rec., 258):

"At our meeting of the 22d inst. we increased the capital stock to $350,000. Estimating our business the same as last year, we can pay the interest on $300,000 of bonds and still continue dividends the same as we are now paying of one per cent. a quarter on the stock or four per cent. per annum."

In acknowledging the two letters of April 27, Elliott, Johnson & Co. say (Rec., 236):

"Our present plan is to offer the bonds in our circular at 95, with but 25 per cent. in stock. We do this so that we make large concession in price and give the additional stock to some big customers we hope to induce to purchase. They will be very much more apt to buy if they think special terms are made for them. We hope to be able to work off most of the bonds this way. Kindly forward us maps, as many as you can spare, up to one hundred. We propose to take off our coats and push this matter so soon as it is in complete shape. To offer it earlier would hurt it. We shall work with confidence as we believe in your company and yourselves."

It turned out to be unnecessary for Elliott, Johnson & Company to give away the surplus stock to induce big

purchasers to come in, so they kept it themselves as part of their profit in the transaction (Rec., 247). In fact, they agreed not to give anyone more than 25 per cent. of stock (Rec., 242).

Increase of Stock in 1889.

The resolution in regard to increase of stock, a copy of which was sent to Elliott, Johnson & Co., with Mr. Carlisle's letter of April 21, 1889 (Rec., 257), were as follows (Rec., 348, 349):

> "Whereas, there have been expended for permanent improvements and betterments, including machinery, barges, flats, etc., during the years 1884, 1885, 1886, 1887 and 1888, more than the sum of one hundred and sixty thousand dollars, all of which sum has been furnished from the net earnings of the company and fairly belongs to the stockholders of the company; therefore
>
> "*Resolved*, That the directors of this company be, and hereby are, authorized and requested to direct the president and secretary of the company to issue one thousand shares of the capital stock of the company, to be divided pro rata among the present stockholders of this company as follows:
>
> To B. D. Harris, 300 shares.
> To G. D. Harris, 300 shares.
> To John Carlisle, 220 shares.
> To G. W. Carlisle, 150 shares.
> To George S. Richardson, 26 shares.
> To James C. Holden, 2 shares.
> To Loring Hinsdale, 2 shares."

The resolution of the directors was of substantially the same tenor, and directed stock to be issued accordingly (Rec., 351).

In accordance with this resolution 300 shares of stock were issued to B. D. Harris, represented by certificates Nos. 41, 45 and 46 (Rec., 222, 223). All this stock was transferred out of the name of B. D. Harris prior to March 8, 1890 (Rec., 222, 223). Corresponding amounts

of stock were issued to all the other stockholders, *pro rata*, according to the terms of the resolution.

Elliott, Johnson & Co. knew that this stock, thus issued to the former stockholders, was the stock to be delivered to their customers. They were told so by Mr. Carlisle (Rec., 104, 138), and in their letters asking for stock they frequently asked that it should be "transferred" to the names which they furnished (Rec., 242, 243, 244, 245, 247, 248, 250, 252). When they pledged certain bonds as collateral for money borrowed by the company, they omitted the stock, recognizing that it was not property of the company (Rec., 251).

Sale of Stock and Bonds through a Common Agent.

In order to enable the stock to be delivered in connection with the bonds, for a gross price, Mr. Reuben Tyler, counsel to the company, prepared a form of agreement which was intended to avoid any legal objection to the company's dealing in its own stock. A copy of this was sent by Mr. Carlisle to Mr. Harris with his letter of April 27, 1889, in which he said (Rec., 274):

> "I also enclose a proposition of the stockholders which Mr. Tyler carefully prepared, so that we could legally take the $75,000. The company cannot legally buy its own stock and reissue it. If bought by the company it must be cancelled. If you approve, please sign and have your brother sign, and return to me, when we will sign it; then I shall have a meeting of the board here and accept the proposition."

The proposition referred to was signed by all the stockholders, except Holden and Hinsdale, and was laid before the Board of Directors at a meeting held May 13, 1889, at

which B. D. Harris was not present (Rec., 352). The proposition was as follows:

"PROPOSITION OF STOCKHOLDERS OF THE GREAT WESTERN MINING AND MANUFACTURING COMPANY TO THE DIRECTORS OF SAID COMPANY.

"WHEREAS, the directors of the Great Western Mining and Manufacturing Company have taken steps to borrow the sum of $300,000 to be used in payment of existing indebtedness of the company, and to provide additional working capital, &c., and have authorized the president and secretary to execute bonds for said amount, and negotiate the same at the best price obtainable.

AND WHEREAS, we are informed that it will probably be possible to find purchasers for said bonds at the price of eighty-five per cent. of the par value thereof, provided stock of the company, to the extent of fifty per cent. of the par value of the said bonds, shall also be transferred to the several purchasers of said bonds;

AND WHEREAS, it is deemed to *him* expedient to issue any new stock of the company for such purpose; and desiring to do all we can to assist the Directors in procuring said loan and the sale of said bonds;

WE THEREFORE make this proposition to the directors of the company in reference to the sale of stock held by us in said company, to the purchasers of the said bonds, to wit:

We will sell to the several purchasers of said bonds of the company, stock of the company belonging to us, in the amounts set opposite to our names respectively, and will furnish to the secretary of the company certificates of said stock, assigned in blank, to be by him delivered to said purchaser of said bonds, upon the understanding and agreement, that we are to receive the sum of $50 for each share of stock so sold by us, out of the money paid for said bonds, and said secretary shall act as our agent in receiving said amounts, and shall pay us the same, before the company shall be entitled to have the remainder of the money paid for said bonds by the purchasers thereof.

This action is not to be constructed as a proposition to sell said stock to the company, but it is to be treated and regarded as a sale of stock directly to the purchasers of said bonds, to be paid for by them to us, and the payment by them to the secretary of this company, for said

bonds, shall be regarded as a payment to us for said stock to the extent necessary to pay us therefor upon the terms above stated.

In testimony whereof, we have hereunto set our hands on this third day of May, 1889.

B. D. HARRIS.....	450 Shares.
G. D. HARRIS.....	450 Shares.
JOHN CARLISLE	336 Shares.
GEO. S. RICHARDSON.....	39 Shares.
G. W. CARLISLE.....	225 Shares.
Total.....1,500 Shares."	

The directors' minutes show (Rec., 353):

"After full consideration of the proposition, the same was accepted, and the secretary was authorized to act as the agent for said stockholders in the proposed sale of their stock and the collection of the purchase money therefor, and directed to turn over the net proceeds of the sale of bonds into the treasury of the company."

As required by their contract with the Company, the stockholders delivered to the Secretary, from time to time during the year 1889, certificates for full-paid shares to the amount of $150,000 (Rec., 131), and the Secretary transferred these shares on the books to the names of persons designated by Elliott, Johnson & Co., and forwarded the certificates to Elliott, Johnson & Co. for delivery (Rec., 105).

In remitting for the bonds and stock Elliott, Johnson & Co. used a standard form of correspondence substantially as follows (Rec., 245):

"In payment for $6,000 Gt. Western Mng. & Mfg. Co. 1st 6's with $3,000 stock of the same company at 85, we enclose our check No. 8,597 to your order for $5,100."

From the undisputed facts it is apparent that the money was paid for the bonds and stock; that it came into the possession of John Carlisle, as joint agent of the stockholders and the corporation, and was by him divided between

them according to their agreement. The real nature of the transaction is not obscured even by the ingeniously worded questions put to Mr. Carlisle by the complainant's counsel. His testimony at pages 130 and 131 of the Record is as follows:

"Q. Mr. Carlisle, after this $75,000 was paid and realized from the sale of these bonds, and received by the company, I understand it came into your possession as treasurer?

A. Yes, sir.

Q. How was the money distributed among the stockholders? Who paid it in proportion to the amount of stock which they had transferred?

A. I did.

Q. You paid it out of that money, did you, that you received from Elliott, Johnson & Co.?

A. I paid for the stock out of the money I received from Elliott, Johnson & Co.

Q. In what manner did you pay it? for example, how did you pay G. D. Harris?

A. Under the arrangement made with the stockholders each one furnished *pro rata* their proportion of stock, which was put in my hands, and whenever sold each was to receive the proceeds. As I received the money from Elliott, Johnson & Co. I would send checks to the different parties for their stock that was sold with the bonds.

Q. Did you pay them from time to time?

A. I paid them from time to time as I received it from time to time.

Q. Was all the stock in your possession?

A. All the stock was sent to me when I requested it, the total of 1,500 shares.

Q. Had the certificates ever gone out of your possession?

A. Oh, yes, long previous to that.

Q. Were they all sent back at one and the same time?

A. No, they were all sent back at different times.

Q. Was there correspondence between you and B. D. Harris showing that?

A. I think some of it shows where I acknowledged the receipt of stock, where I wrote him to send me stock. I think that shows in that.

But I would generally get the stock from B. D. Harris when I went East and save registering the letter, you know."

The sale of bonds and stock proceeded with reasonable success during the Summer of 1889. By July 3, 1889, more than two-thirds had been sold (Rec., 247, 248). In the Fall of 1889 the market for all kinds of investment securities was very weak (Rec., 254), and Elliott, Johnson & Co. gave an option on all the remaining bonds to a German banker (Rec., 284). The option was not exercised. A statement dated January 11, 1890, shows 43 bonds remaining unsold (Rec., 287). In March, 1890, B. D. Harris wrote to John Carlisle as follows (Rec., 283):

"I hope you will at once notify Elliott & Co. that the bond deal will positively be closed April 1st, and that all bonds remaining unsold at that date must be promptly returned to you.

They certainly ought to dispose of the remaining $90,000 (I understand that is the amount unmarketed) before April 1st, but, if they don't, my brother and I will take one-fourth, you another, and the working capital one-half at 85 and 50 per cent. stock and close the deal in this way. I am not willing that this shall hang along a single day beyond the time named."

The Controversy about Supporting the Market.

About this time general financial conditions became more unfavorable, and Elliott, Johnson & Co. began to press the Harrises and Carlisles upon an alleged agreement to "support the market" for bonds and stocks of the Great Western Mining and Manufacturing Co. This suggestion was energetically opposed by B. D. Harris, who wrote to John Carlisle, under date of March, 15, 1890, as follows (Rec., 238):

"In my opinion it would be absolute suicide for the company to enter into any such scheme involving obligations to buy back the securities we

have had so much trouble and expense to sell. To sustain the market effectually would surely bankrupt the company. You say they (Elliott & Co.) 'wish us to list the bonds as per agreement.' What agreement? At the time they claim it was made my brother and I, owning three-fifths of the stock, had no knowledge whatever of any such scheme, and of course, never agreed to it and have never since agreed to it. On the contrary, the only time it was ever mentioned to me in the presence of Elliott & Co. (Mr. Scott) I emphatically opposed it, finally saying that if it was done at all it should be by individuals and never by the company, and I did not agree to this even, but said I should consider it when the time came; it would be simply throwing away whatever was put up without a penny's benefit to anybody except the brokers. What do we care whether the bonds sell on the market or not? Our only concern should be to pay interest and dividends."

Elliott, Johnson & Co. still persisted in their claim that the Harrises and Carlisles should support the market, and it is evident that the discussion reached a certain degree of warmth. Under date of June 2, 1890, Mr. Harris wrote to John Carlisle (*Rec.*, 292):

"Herein find letter from Elliott, Johnson & Co. with copy of my reply. It is decidedly cheeky to say I offered to put up money to sustain bonds. I did nothing of the kind, being very careful while saying nothing to interfere with the sale of bonds, to make no positive promises and I did not make any. I know what I was about and unless they want to quarrel with me, Elliott & Co. had better not accuse me of saying one thing and doing another. That is not my style."

John Carlisle was willing to fall in with the suggestion about supporting the market (*Rec.*, 263), and if it had not been for the determined opposition of Mr. Harris, the funds of the company would probably have been used, as Elliott, Johnson & Co. insisted they should be used, in sustaining the price of its bonds upon a falling market. The memory of this episode may tend to explain the attitude of Elliott, Johnson & Co. toward Mr. Harris in the course of subsequent events.

Causes and Results of the Receivership.

One result of the sale of stock was that the Harrises lost control of the company, and a voting control rested with Elliott, Johnson & Co. in conjunction with John Carlisle. At the annual meeting in 1890, Mr. Holden retired as a director, and his place was taken by H. P. Scott, of Elliott, Johnson & Co. (Rec., 354).

The business of the company in 1890, 1891 and 1892 continued to be profitable (Rec., 140). The earnings in the first half of 1889 were about $19,000 (Rec., 295). For the last half they do not appear, but in 1891 they were about $33,000 (Rec., 148). Dividends were declared, but some of the larger stockholders left their dividends uncollected, as a loan to the company, because extensive betterments and improvements were being made, and the company needed the money (Rec., 149, 141).

The directors' minutes of this period indicate a considerable willingness to incur liabilities. April 24, 1889, the directors voted to acquire the stock and assets of the Elevated Railway & Coal Company of Cincinnati, at a cost of $12,000, and to improve the same at a cost of $3,000 (Rec., 354). April 23, 1891, the purchase of the capital stock of the Carlisle Coal Company was authorized at a cost of $30,000, and improvements, &c., to cost $20,000 (Rec., 357). July 15, 1891, a change in the system of mining at a cost of $5,000 was authorized (Rec., 358). At the stockholders' meeting held April 28, 1892, the directors were authorized and empowered to borrow $30,000 for the purpose of utilizing the waste at the mines for making brick (Rec., 359, 360). All the moneys appropriated by these resolutions may not have been used, but large

sums were certainly expended on miscellaneous extensions and improvements (Rec., 141, 149), thereby creating a large floating indebtedness.

At the directors' meeting held September 21, 1892, the minutes show (Rec., 362):

> "Mr. Carlisle reported that his failure had compelled an application to the U. S. Court for the appointment of a receiver of the company by reason of his name being endorsed on the company's notes for coal purchased, and the holders of said notes bringing suits and attachments against the company, the application was made in order to save the property and prevent its being sacrificed.
>
> The Court appointed Mr. L. C. Black, receiver, on September 13th."

The order continuing the receiver appears at page 362 of the record, by which it would appear that he was an ordinary chancery receiver, without any special statutory powers.

Among the liabilities of the company appeared a great many notes of the company, endorsed by John Carlisle (Rec., 373 to 377). One, at least, of these represented an indebtedness not incurred for the benefit of the Great Western Mining and Manufacturing Company (Claim of Cincinnati Volksblatt Co., Rec., 150). Mr. Carlisle denied that there were any others, and the evidence does not show what the fact was.

During the first six months of the receivership the earnings were at a rate which, if continued, would have been sufficient to pay the interest on the bonds (Rec., 184). Nevertheless, a reorganization committee was formed, of which Mr. Scott, of Elliott, Johnson & Co., was a member (Rec., 183, 327), and so promptly were the proceedings conducted that a Master's report of the amount due was filed October 16, 1893 (Rec., 380), and a foreclosure

sale had December 23, 1893 (Rec., 181, 377). An application was made to the Court in the Summer of 1893 to direct the receiver to pay the interest, but for some reason it was never pressed (Rec., 184). The counsel for the bondholders' committee were also counsel for the receiver (Rec., 183), and at the foot of one of the receiver's schedules appears the significant note (Rec., 385):

"I have not written E. J. & Co. on this subject."

The purchasers at the foreclosure sale were the bondholders' committee, who have continued to operate the property as an active mining enterprise under a corporate organization (Rec., 182).

The Proposed Suit against Mr. Harris.

The evidence differs as to the time when Mr. Black and Mr. Scott first talked over the project of bringing suit against Mr. Harris. Mr. Scott says that the matter of the division of the proceeds of sale of bonds and stock was first brought to his attention by Mr. Black when he was "attempting to reorganize the property" (Rec., 25). This must have been in 1893. Mr. Black thinks the conversation occurred "in connection with the closing up of the sale of the property" (Rec., 183). However that may be it was not until January 22, 1895 (Rec., 365, 366) that the receiver presented to the Court a petition stating in substance as follows:

"Your receiver says that he finds shares of capital stock of the Great Western Mining and Manufacturing Company were issued at the instance of and through the action of certain of said stockholders and officers of said company, to the amount of $150,000, which said stock was distributed among said stockholders and officers; that, as your receiver is informed and believes, there was no consideration for the issue and distribution of said stock; that the said stock was sold by said stockholders,

so as aforesaid receiving it, to the defendant The Great Western Mining and Manufacturing Company, and by means of said sale moneys to the amount of $75,000 were abstracted from the treasury of said company; that the issue and distribution of said capital stock was, as your receiver believes, a mere device or instrumentality to abstract said moneys from the treasury of said company; that said company, as your receiver believes, has a valid claim against said persons to recover said moneys; that some of said parties are solvent and able to repay said monies, and proceedings should be taken to recover it for said company and its creditors."

The receiver then goes on to make a general charge of negligence against the directors, and prays the direction of the Court as to his duty in the premises.

We are at a loss to understand why, in thus seeking the aid and direction of the Court, the receiver should have failed to disclose the facts constituting the real difficulty of the problem, viz.:

(*a*) That the increased stock was distributed *pro rata* among all the stockholders.

(*b*) That the relative interest in the corporation represented by such stock was not retained by the old stockholders or by the company, but was sold to new stockholders.

(*c*) That such sale was necessary in order to enable the corporation to float its bonds.

(*d*) That the moneys received by the old stockholders were limited to the agreed value, which was also the actual value, of the relative interest in the corporation which they turned over to the new stockholders, in connection with the purchase of bonds.

Evidently the receiver considered that the advice of the Court, given upon an incomplete statement of facts, would be at least as useful to him as if it were given with

full knowledge. Upon the receiver's meagre statement of the case the Court made an order as follows (Rec., 366):

> "This cause coming on to be heard upon the application of L. C. Black, receiver herein, asking for instructions as to his duty in the matters and things set forth in the said application, and wherein said receiver represents to the Court that in certain transactions connected with the floating of a loan of $300,000 upon the property of the Great Western Mining and Manufacturing Company, apparently $75,000 was withdrawn by certain stockholders and officers of the said company, whereas the same should have been paid into the treasury of the said company; and wherein said receiver further represents that apparently certain stock was issued to the stockholders and officers of the said company without consideration, and that apparently by reason of the inattention and negligence and mismanagement of the board of directors of the said company and the misappropriation of the funds of the said company, said company has been greatly damaged and its assets depreciated.
>
> And its appearing to the Court that it will be for the advantage of the said company that suit shall be instituted against the stockholders and directors of the same for the recovery of the sums so represented to be lost, it is therefore directed that said receiver proceed in his own name as receiver or in the name of the company, as he may be advised, to recover said sums."

Under color of authority of said order the receiver, on July 8, 1895, filed his bill of complaint herein against B. D. Harris as sole defendant (Rec., 1, 2). B. D. Harris appeared and answered, and thereafter the cause was allowed to languish until September, 1898, when the testimony of Henry Scott was taken at Wilmington, Del. (Rec., 18). B. D. Harris died shortly thereafter, on or about January 19, 1899 (Rec., 28), and a motion was made to revive the suit against the executors (Rec., 27), which was granted by the learned Circuit Court upon the ground that the cause of action, so far as it sought an accounting for personal profit made by the deceased director at the expense of the corporation, was one which

survived (Rec., 31, 32). Testimony having been taken, the cause was brought on for hearing before Judge WHEELER, in February, 1902. The complainant then claimed a declaration by the Court that the estate of B. D. Harris was liable (Rec., 193):

"(1) For the sum of $75,000 as a joint and several liability of the directors and officers of the company, with interest thereon from January 11, 1890, the first date shown by the record that the $75,000 had been taken from the company (Exhibit 98, letter, John Carlisle to B. D. Harris, dated January 11, 1890).

(2) For $45,000 as a several liability as stockholder, on account of the issue to himself, without consideration, on January 11, 1888, of one hundred and fifty shares or $15,000 of stock, and on April 22, 1889, three hundred shares or $30,000 of stock to be accounted for $15,000 as of January 11, 1888, and of $30,000 as of April 22, 1889.

(3) For the damages suffered by the company by reason of the issue to other stockholders of the Great Western Mining and Manufacturing Company by B. D. Harris and the other officers and directors of the company on January 18, 1888, of three hundred and fifty shares or $35,000 of stock, and on April 22, 1889, of seven hundred shares or $70,000 of stock without consideration, to determine which said damages and injury a reference should be had to a master.

(4) For the dividends wrongfully paid out of capital stock between April, 1889, and July, 1892, as a joint and several liability of the directors and officers of the company so paying said dividends, and for the dividends paid B. D. Harris individually as a several liability of his estate."

For reasons stated in his opinion (Rec., 185–191) the learned Judge gave judgment against the executors for $15,000, being the amount received by B. D. Harris upon the sale of stock of the increased issue of 1889 (Rec., 194).

Both parties appealed, and the learned Circuit Court of Appeals reversed the judgment of the Circuit Court and dismissed the bill (Rec., 386 to 400).

The cause was then removed to this Court by certiorari (Rec., 402).

The Pleadings.

The bill of complaint charges that on November 10, 1887, the Great Western Mining and Manufacturing Company had outstanding 2,000 shares of stock of the par value of $100 each; that 600 of these shares of stock were owned by B. D. Harris (Rec., 2); that on said day the corporation increased its capital stock and distributed 500 additional shares among its stockholders *pro rata*, B. D. Harris receiving 150 shares; that on April 22, 1889, it again increased its capital stock and distributed 1,000 shares *pro rata*, B. D. Harris receiving 300 shares (Rec., 3); that said issues of stock were made ostensibly to represent betterments paid for out of the net earnings of the company; that in fact there were no such betterments or earnings (Rec., 3); that the corporation was insolvent; that the stock was worthless and issued without consideration (Rec., 5, 4); that said issues of stock were made in pursuance of a plan for issuing mortgage bonds and selling the same with a bonus of stock (Rec., 3, 4); that afterwards $300,000 of bonds were sold with a bonus of stock amounting to 50 per cent. of their par value, at a price equal to 85 per cent. of the par value of the bonds (Rec., 5); that of the stock used as bonus, B. D. Harris furnished 450 shares, and that there was paid to him out of the proceeds of the transaction $22,500; that the transaction amounted to a sale to the company of its own stock at the rate of fifty cents on the dollar (Rec., 5); that all the other stockholders furnished stock and received payment out of the proceeds in like manner and at the same rate; that the directors negligently left the sole management of the business of the company in the hands of John Carlisle, its

treasurer, and permitted and directed said John Carlisle to pay certain dividends to sundry persons whose names were unknown to the complainant, when, in fact, the company had made no profits out of which such dividends could be paid; that the company suffered damage in other ways on account of the negligence of the directors in leaving the management of its affairs to John Carlisle (Rec., 6); that on or about September 12, 1892, in a suit brought by the assignee of John Carlisle, one L. C. Black was appointed receiver of the assets of the company for the purpose of realizing upon the same for the benefit of its creditors; that in said proceeding all the property of the complainant was appraised and sold and found to be of the value of $75,666.66, leaving a floating indebtedness outstanding of about $90,000, besides a balance of about $270,000 upon the bonded indebtedness of the company (Rec., 6); that the receiver did not discover the matters set forth in the bill until March, 1894, and that by an order of the Court appointing him he had been directed to bring this suit, either in his own name or in the name of the corporation, as he thought proper (Rec., 7). The bill also, at various stages, charges the existence of a conspiracy and fraudulent intent on the part of all the directors and stockholders, and characterizes their acts as "defrauding said company," "abstracting the assets of said company, "abstracting from the assets of said company money arising from the sale of said bonds" (Rec., 3, 4, 5), and, also, that "all the issues of stock after the first issue thereof were fictitious, fraudulent, illegal and void" (Rec., 7).

The answer denies the charges of conspiracy and fraud-

ulent intent (Rec., 10, 12), alleges that the money paid to B. D. Harris was his own money (Rec., 12), and that the same was received by John Carlisle as his agent, derived from the sale of his property (Rec., 12); that the stock issues were made in good faith and were believed by the stockholders and directors to be warranted by the value of the property and the betterments placed thereon (Rec., 10, 11); that such belief was justified by the report of an experienced mining engineer and geologist (Rec., 11); that all the transactions complained of had been approved and assented to at the time by all the stockholders and directors (Rec., 15); denies that any stock was sold to the company or that the company paid for the stock (Rec., 19); denies that the company was insolvent or that any dividends were paid, except from net earnings (Rec., 19); answers fully the charge that John Carlisle was negligently permitted to mismanage the affairs of the company (Rec., 13, 14); avers that the temporary embarrassment of the company in September, 1892, was due to the prevailing depression in business, the great shrinkage in values and the difficulty of procuring ready money by which many other enterprises in the country were affected to an even greater extent (Rec., 14); that the application to the Court for a Receiver was made at the instance of the principal stockholders for the purpose of protecting the company's interest; that the earnings of the company during the first three months of the receivership were $7,000, or nearly twice the amount needed to meet the interest on the bonds; that the receiver afterwards so mismanaged the company that great losses were sustained and the bond-

holders were enabled to combine and bid in the property at a nominal price (Rec., 14), and that the property was acquired by a syndicate, which reorganized it with a capitalization of $650,000 (Rec., 15).

Brief of the Argument.

We will present our argument in relation to this case under the following heads:

I.—The limitations inherent in the alleged cause of action render inapplicable many of the arguments advanced in support of the appeal.....(page 35)

(*a*) The bill was properly dismissed unless the facts alleged and proved established a right vested in the Corporation.

(*b*) The bill was properly dismissed unless the facts alleged and proved established a cause of action which survived against the personal representatives of the deceased director by the laws of Vermont.

(*c*) The bill was properly dismissed unless the facts alleged and proved established a cause of action within the equitable jurisdiction of the Circuit Court.

(*d*) The bill was properly dismissed unless the facts alleged and proved established a cause of action within the scope of the order authorizing the Receiver to sue in the corporate name.

II.—The concurrent judgment of the Courts below upon the questions of fact involved, should not be disturbed except for manifest error.....(page 43)

III.—The issue of an increased number of shares *pro rata* had the effect merely of enabling the stockholders to split up their respective interests into more convenient fractions. It did not deplete the assets of the corporation.....(page 45)

IV.—The share stock, regardless of the time of issue, was the property of the individual shareholders and not of the corporation.....(page 52)

V.—The fact that bonds and stock were sold through a common agent to the same purchasers did not injure the corporation, provided the proceeds were fairly divided.....(page 60)

VI.—There was a fair division of the proceeds of sale as between the bonds and stock.....(page 66)

VII.—The bill is not sustainable on the ground that Elliott, Johnson & Co., were deceived.....(page 68)

(*a*) No such issue has ever been tried.

(*b*) Elliott, Johnson & Co. had no interest in the matter beyond earning their commissions.

(*c*) There was no deception in fact.

(*d*) B. D. Harris never had any communication with Elliott, Johnson & Co., except of the most general nature.

VIII.—The bill is not sustainable on the ground that the purchasers of bonds and stock from Elliott, Johnson & Co. were deceived .....(page 75)

(*a*) No such issue has ever been tried.

(*b*) There is no evidence that any purchasers were deceived.

(*c*) It is extremely improbable that any deception occurred.

(*d*) Even if a promise was made to use the proceeds of sale in a particular way, that did not impress the proceeds with a trust.

(*e*) The judgment, if any, recovered by the complainant in this case would not enure to the benefit of the purchasers, if any, who were deceived.

(*f*) If any fraud was committed, defendants' testator had no part in it.

(*g*) If any fraud was committed, it was not injurious to the corporation.

IX.—The bill is not sustainable on the ground that B. D. Harris was a promoter and bound, as such, to account for profits.....(page 97)

X.—The bill is not sustainable upon the ground that it is brought for the avoidance of a transaction between the corporation and one of its directors or to compel a director to account for illicit profits.....(page 108)

XI.—The bill is not sustainable upon the ground that it was *ultra vires* of the corporation to deal in its own stock.....(page 115)

XII.—The claim for repayment of dividends is not supported by allegations or proof.....(page 124)

XIII.—The bill is not sustainable on the ground of liability on stock not full paid.....(page 125)

XIV.—The corporation and all its stockholders are estopped from questioning the transactions now complained of.....(page 126)

(*a*) Prior creditors were all paid.

(*b*) Subsequent creditors cannot and do not object.

(*c*) All stockholders at the time consented.

(*d*) The present stockholders are bound by the assent of their predecessors in title.

XV.—The order of the Circuit Court for the District of Kentucky was not effective to authorize the receiver to maintain a suit in the name of the Great Western Mining and Manufacturing Company in the Circuit Court for the District of Vermont.....(page 144)

I.

The limitations inherent in the alleged cause of action render inapplicable many of the arguments advanced in support of the appeal.

Under this heading we propose to call attention, briefly, to some of the obvious limitations applicable to the only cause of action upon which the complainant could possibly hope to obtain judgment—limitations not always regarded in the bill or in the subsequent arguments of the complainant's counsel—but which are nevertheless too elementary to require separate or extended discussion.

It was held by the learned Circuit Court of Appeals that the receiver had no right at all to file this bill in the District of Vermont, the receivership not having been extended to that District by appropriate proceedings. That question will be discussed under a separate Point (XV). For the purpose of getting at the merits of the case we will assume that the receiver had due authority and legal capacity to file the bill, and that the nature of his claim

is substantially as set forth in his petition to this Court for the writ of certiorari.

(a) *The bill was properly dismissed unless the facts alleged and proved established a right vested in the corporation.*

The proposition that the recovery in an action, if any, must be by virtue of some right vested in the person who is put forward in the bill of complaint as complainant, seems so manifest as to require little or no argument for its support.

This principle is illustrated by cases which have frequently arisen in the federal courts upon the question of diversity of citizenship, where a suit has been brought by an infant by next friend, the next friend being a citizen of same State as the defendant, but the infant being a citizen of a different State. In these cases the Court has held that the infant is the real party, and that his citizenship and not that of the next friend governs.

Williamson *vs.* Ritchey, 3 Dill.,406; Fed. Cas., 17734.

Woolridge *vs.* M'Kenna, 8 Fed. Rep., 650.

Voss *vs.* Neienber, 68 Fed. Rep., 947.

Dodd *vs.* Ghiselin, 27 Fed. Rep., 405.

The same rule applies in case of an action by a *feme covert* by next friend.

Ruckman *vs.* Palisade Land Co., 1 Fed. Rep., 367,

and in case of an action by a *non compos mentis* by next friend.

Wiggins (known as "Blind Tom") by next Friend, &c., *vs.* Bethune, 29 Fed. Rep., 51.

The converse of these propositions is the recognized rule that the plaintiff himself must have a right to sue and, if not, a suit by him for the use of those who could sue is not maintainable.

Buchter *vs.* Dew, 39 Ill., 40;
Larned *vs.* Carpenter, 65 Ill., 543.

In other words, if the cause of action in the present case does not exist in the corporation but in the receiver, or in some one else, then the suit is not maintainable. The receiver had his option to sue in his own name or in the name of the corporation, and he is bound by his choice. No matter what his powers may be as receiver, he cannot, in an action brought in the name of the corporation and in which the citizenship of the corporation is relied upon to sustain the jurisdiction, assert rights which do not belong to the corporation and which were never vested in the corporation.

(b) *The bill was properly dismissed unless the facts alleged and proved established a cause of action which survived against the personal representatives of the deceased director, by the laws of Vermont.*

The survival of causes of action arising under or subject to the operation of State laws is determined by those laws. In other cases it must be determined by the principles of the common law, as recognized and administered in the federal courts.

U. S. *vs.* De Goer, 38 Fed. Rep., 80.
Martin *vs.* B. & O. R.R. Co., 151 U. S., 673.

In a case where the cause of action arises in one State and suit is commenced in another the law of the State in

which the suit is brought and being proceeded with, and not of the State where the cause of action arose, governs.

B. & O. R.R. Co. *vs.* Joy, 173 U. S., 226.

The common-law rule is that a cause of action does not survive merely for an injury done, but only for the benefit derived by the defendant from such injury; and in such case only the cause of action for the value of the property shall survive against the executor.

United States *vs.* Daniel, 6 How., 11.

Witters, &c., *vs.* Foster, Adm., 26 Fed. Rep., 737.

Or, as the rule is aptly expressed by Lord Mansfield in *Hambly* vs. *Trott*, 1 Cowp., 376:

> "Where, besides the crime, property is acquired which benefits the testator, there an action for the value of the property shall survive against the executor. * * * So far as the tort goes an executor shall not be liable, and, therefore, it is that all public and all private crimes die with the offender, and the executor is not chargeable; but, so far as the act of the offender is beneficial, his assets ought to be answerable, and his executor shall therefore be charged."

That actions for wrongs not involving personal profit to the wrongdoer do not survive in Vermont is well established by decisions of the courts of that State.

Barrett *vs.* Copeland, 20 Vt., 244.

Winhall *vs.* Sawyer, 45 Vt., 466.

The petitioner cites no statute of Vermont on the subject of the survival of causes of action, and it must, therefore, be assumed by this Court that in Vermont such survival is controlled by the principles of the common law. There is, in fact, a section of the Revised Laws of Ver-

mont on this subject, but, as stated in the opinion of Wheeler, *J.*, in *Witters* vs. *Foster*, 26 Fed. Rep., 737, this statute is not any more broad than the English statute of 4 Edw. III., c. 7.

(c) *The bill was properly dismissed unless the facts alleged and proved established a cause of action within the equitable jurisdiction of the Circuit Court.*

The learned Courts below did not err in refusing to grant relief upon matters not of equitable cognizance, notwithstanding the failure of the defendant to affirmatively plead the existence of an adequate remedy at law.

Allen *vs.* Pullman's, &c., Car Co., 139 U. S., 658.

Lewis *vs.* Cockes, 23 Wall., 466.

The bill in this case prayed, among other things, for a decree holding the defendants liable for loss caused to the Mining Company by the negligence and misconduct of their testator. Inasmuch as the petitioner still persists in this claim, notwithstanding it was rejected by the learned Courts below as not involving any matter of equity, the question arises, does loss caused a corporation by the directors' mis-feasance or non-feasance, furnish *per se* a case for equitable relief? In other words, is there an adequate remedy at law available to the corporation?

The answer seems to be that in respect to the powers with which they are invested directors are merely agents, while in respect to property of the corporation of which they may obtain title or actual posses-

sion they are to be regarded as trustees. For an abuse of power, therefore, the remedy is at law, while for an appropriation of assets to his own benefit the delinquent director may be pursued in equity.

Bay City Bridge Co. *vs.* Van Etten, 36 Mich., 210.

Marvin *vs.* Brooks, 94 N. Y., 71.

O'Brien *vs.* Fitzgerald, 143 N. Y., 377; 150 N. Y., 572.

Dykman *vs.* Keeny, 154 N. Y., 483.

Marsh *vs.* Kaye, 168 N. Y., 196.

American Sprits Mfg. Co. *vs.* Easton, 120 Fed. Rep., 440.

Boyd *vs.* Mutual Fire Ass'n (Wis., 1903), 116 Wis., 155, 178.

The case which seems to be relied upon by the petitioner is *Briggs* vs. *Spaulding*, 141 U. S., 132. That was a bill by a receiver of a National Bank against certain directors and executors of certain others, deceased, to charge them with liability for various acts of mis-feasance and non-feasance. The actual decision in that case was the dismissal of the bill on the hearing without costs as to those of the defendants who answered, and with costs at to those against whom the bill was taken as confessed. How any comfort can be afforded to the petitioner by this case is hard to say, inasmuch as counsel for neither party raised this question and neither the Court before whom the bill came on for hearing (30 Fed. Rep., 298) nor this Court upon appeal thereto, considered the question at all in their opinions. The point discussed by both courts was what constitutes ordinary

care on the part of a trustee, and this Court said on page 147:

> "Bank directors are often trustees, but not in any technical sense. The relation between the corporation and them is rather that of principal and agent. Certainly so far as creditors are concerned, between them and the corporation the relation is that of contract and not of trust."

In *National Bank of Commerce* vs. *Wade*, 84 Fed. Rep., 10; *Cockrill* vs. *Cooper*, 86 Fed. Rep., 7; and *Robinson* vs. *Hall*, 43 Fed. Rep., 222, bills in equity by receivers of National Banks against directors thereof for mis-feasance and non-feasance were entertained. But despite the *obiter* remarks of the learned District Judge in the case first cited, the fact remains that these cases have little bearing upon the general question, for the reason that the rights and liabilities of creditors, stockholders and directors of National Banks are based entirely upon a comprehensive and exhaustive statute, the purpose of which was to safeguard in every way, however unusual, the interests of the public; so that any case upon the liability of directors or stockholders of a national bank is simply a case of the interpretation of a particular and peculiar statute with a history entirely its own. The decisions under this statute really shed no more light on the question now under consideration than do the numerous decisions to be found in the State courts regarding the liability of the managers of savings banks.

(d) *The bill was properly dismissed unless the facts alleged and proved established a cause of action within scope of the order authorizing the receiver to sue in the the corporate name.*

Inasmuch as the receiver had no authority to use the

name of the corporation as complainant except that derived from the order of the Court which appointed him, and inasmuch as that order was limited to the enforcement of certain specified demands, it follows that any attempt to use the name of the corporation to enforce other demands was unauthorized, and the bill to that extent cannot be entertained.

Booth *vs.* Clark, 17 How., 322, 331.
Wynn *vs.* Lord Newborough, 3 Bro. C. C., 88.
Swing *vs.* White River Lumber Co., 91 Wis., 517, 522.
Reynolds *vs.* Pettyjohn, 79 Va., 327, 331.
Pouder *vs.* Catterson, 127 Ind., 434.
Merritt *vs.* Merritt & Lyon, 16 Wend., 405, 410.
Beach on Receivers, § 650.

The possible grounds of complaint are limited, therefore, to those specified in the order of the Circuit Court for the District of Kentucky (Rec., 367), viz.:

(1) Withdrawing part of the proceeds of a loan which should have been paid into the treasury of the company.

(2) Issuing stock without consideration.

(3) Inattention, negligence and mismanagement as a director.

(4) Misappropriation of the funds of said company.

II.

The concurrent judgment of the courts below upon the questions of fact involved, should not be disturbed except for manifest error.

Hy-Yu-Tse-Mil-Kin *vs.* Smith, 194 U. S., 401, 412.

Illinois *vs.* Illinois Central R. Co., 184 U.S., 77.

Upon the question whether moneys were improperly withdrawn by the defendants' testator in connection with the loan floated in 1889, which should have been paid into the treasury of the Great Western Mining and Manufacturing Company, the inquiries which arise at the outset are:

(1) Were the moneys remitted by Elliott, Johnson & Co. to John Carlisle proceeds of the sale both of bonds and of stock?

(2) Was the consideration fairly divided as between the bonds and the stock according to relative values?

(3) Had defendants' testator a right to receive that part of the consideration which constituted the proceeds of stock furnished by him for delivery to the purchasers?

The last question is a question of law and upon it the learned courts below differed, in respect to the proceeds of some of the shares of stock.

The first two questions are questions of fact and both the lower courts agreed in answering them in the affirmative.

The learned Judge who delivered the opinion of the Circuit Court said (Rec., 190):

> "Neither statement in the vote of this stock that it was based upon the expenditure of net earnings for permanent improvments, nor the provision in the proposal of the stockholders that the secretary should act as their agent in transferring the stock and receiving the money, nor the protest that the action should not be constructed as a sale of the stock to the company, but should be regarded as a sale to the purchasers of the bonds, could alter the nature of the transaction or its source or its place as a part of the consideration for the money received from the bondholders."

This is a distinct finding that the stock constituted a material part of the consideration for the money received, and it is approved by the Circuit Court of Appeals (Rec., 393). At page 397 that Court says:

> "The evidence shows that the bonds could not be floated without a stock bonus."

Again the learned Judge who delivered the opinion of the Circuit Court said (p. 190):

> "The bonds would not float at 60; the bonds and stock would at 85; the inference follows that the bonds brought 60 and the stock 25."

This is a distinct finding that the division of proceeds was fairly made, according to relative values. This also is approved by the Circuit Court of Appeals (Rec., 398).

If these findings are to be undisturbed, the only question that remains is whether defendants' testator was justified in retaining the proceeds of sale of his own private property, sold by him at the request of the corporation, for the purpose of facilitating it in the exercise of one of its corporate powers, viz., that of borrowing money.

III.

The issue of an increased number of shares *pro rata* had the effect merely of enabling the stockholders to split up their respective interests into more convenient fractions. It did not deplete the assets of the corporation.

The petitioner, at various stages of this case, but always in the same tone of righteous indignation, has denounced various features of the conduct of defendants' testator and his associates as fraudulent and wrongful. It is hard to tell where to begin a defense. In the petition for leave to begin this suit, the principal emphasis was laid upon the alleged issue of stock without consideration (Rec., 365). This is also the ground upon which the learned Circuit Court based its judgment (Rec., 190). We will therefore begin with that element of the alleged cause of action.

The stock increase of 1889 was upon the theory that net earnings to the amount of over $160,000 had been expended in five years for permanent improvements and betterments (Rec., 351). The record shows that about $130,000 had been expended, but not out of net earnings, a part of the money having been advanced by John Carlisle and part provided by an issue of bonds (Rec., 212), and only about $53,000 having been derived from earnings after deducting dividends and interest paid (Rec., 295). There is no proof that B. D. Harris *knew* what amount of net earnings had gone into permanent improvements. On the contrary, the record shows that he relied altogether upon

the statements of John Carlisle as to the condition of the company.

There being no constitutional or statutory prohibition against it, it was entirely proper to issue stock to represent net earnings left with the company for permanent investment as part of the capital.

Bailey *vs.* Railroad Co., 22 Wall., 604, 635.
Williams *vs.* Western Union Telegraph Co., 93 N. Y., 162, 189.

To some extent, at least, the issue of stock in 1889 represented net earnings which had been converted into capital, although not to the full extent of the stock issued. It cannot be said, therefore, that it was altogether without consideration.

Assuming, however, for the sake of argument, that the stock was issued wholly without consideration, who was harmed thereby? Certainly not the corporation. As between the corporation and its shareholders it was a matter of complete indifference by how many shares the interests of the latter were represented. If none of the stock had ever been transferred, the increase would have been wholly without practical effect. The relative rights of the shareholders would not have been altered, either in respect to voting power, or in respect to dividends, or in respect to the final distribution of assets on liquidation. The relation of the aggregate body of stockholders to the corporation, and the corporation's rights and obligations in respect to them would be wholly unchanged.

It is said, however, that the transaction has another color when the stock is issued for the purpose of transferring it. Why so? Has the corporation an interest in the

transfer of its shares? Does it concern the corporation in any way if A admits B to a part of his relative interest in the corporation? A purchaser of shares who buys with full knowledge of all the circumstances is certainly not injured. And even if a purchaser is deceived into buying that which he does not mean to buy, he has his own grievance and his own remedy, and the corporation is not his guardian.

In the case at bar the evidence does not indicate that the stock was increased with any definite intention of disposing of it to the customers of Elliott, Johnson & Co. or to any one else. The stock increase of 1888 was entirely disconnected from any project for the sale of bonds or stock, and the learned courts below have so found (Rec., 189, 392). The stock increase of 1889 was initiated by resolution of the Board of Directors on January 15, 1889 (Rec., 347), before any proposition for the sale of stock in connection with bonds had been made by any one, and before Elliott, Johnson & Co. had ever been heard of in connection with this company. It is true that the final steps were taken at the stockholders' meeting on April 22, 1889, after an extensive correspondence had taken place with the firm last mentioned. The notices of this meeting, however, were sent out on March 26, 1889 (Rec., 348), while Elliott, Johnson & Co. were still considering a proposition for the sale of bonds alone, unaccompanied by stock, as indicated by their letter of April 5, 1889 (Rec., 236).

There is nothing in the record on which to found a belief that the stockholders would have taken any different action from that which they did take, at the meeting of April 22, 1889, even though Elliott, Johnson & Co. had

never been heard of and the necessity for selling bonds had not existed.

But even if we take the view that the stock issue of 1889 was made simply and solely for the purpose of sale to the customers of Elliott, Johnson & Co., that does not support the proposition that the assets of the Great Western Mining and Manufacturing Company were thereby depleted. The situation seems to have been this: The purchasers were not willing to buy either bonds or stock separately. They were willing to give $255,000 for $300,000 of bonds, accompanied by a transfer of three-sevenths of the stockholders' equity. There is not the faintest suggestion in the record that they were deceived in respect to the aggregate number of shares outstanding or in respect to the relative interest in the corporation represented by each share.

That three-sevenths might have been represented by $107,143 of stock out of an issue of $250,000, just as well as by $150,000 of stock out of an issue of $350,000. The substance of the transaction would have been the same. Then each bond would have been accompanied by 35.714 per cent. in stock instead of by 50 per cent. in stock. Such a method of dealing would have been mathematically correct, but practically inconvenient and contrary to financial customs. In substance it would have led to the same result as what was done in this case, but it would have left no room for the argument by which alone the learned Circuit Court was able to convince itself that the money in question was the property of the corporation, and not of the individual stockholder, whose relative interest in the assets was diminished in order to produce the money.

To use another illustration, suppose at the same time when the corporation increased the number of shares from 2,500 to 3,500, it had reduced the par value from $100 to $71.43 per share, leaving the aggregate nominal capital the same as before. No one could claim that the corporation was deprived of anything by such a transaction. Yet that would have enabled the shareholders to have placed a fund of 1,500 shares in the hands of the Secretary for distribution with the bonds, and each purchaser of a $1,000 bond would have received five shares of stock, and those five shares would have represented the same voting rights and the same relative interests in the assets of the corporation that were actually transferred by the proceedings shown in this record.

These illustrations show the fallacy of the distinction drawn by the learned Judge who delivered the opinion of the Circuit Court between the proceeds of stock of the issue of 1888 and the proceeds of stock of the issue of 1889. The latter, he says, was issued as part of the transaction involving the sale of the bonds (Rec., 190). Since the stock was issued to the stockholders without consideration and immediately turned over to the purchasers of the bonds as part of the same transaction, the legal effect is the same, it is said, as though the stock had been issued directly by the corporation to the purchasers. The whole consideration moved from the corporation and it was entitled to the entire proceeds. The receipt by B. D. Harris of $15,000 out of the proceeds of sale of the last issue of stock, therefore, in the opinion of the learned Circuit Court, wrought a depletion of the corporation's assets.

We respectfully submit that this argument involves a

misconception of the effect of the last issue of $100,000 of stock. Before that issue of stock the stockholders owned the entire equity in the assets of the corporation. Subject to the payment of its debts, they were entitled to all the benefit that could be derived from those assets. *After the issue they owned the same thing.* They gained nothing and the corporation parted with nothing by the issue of additional stock. It merely placed in the hands of the stockholders an instrument whereby they could conveniently detract from the value of the shares of stock which they formerly held, in order to vest new and equal rights in the persons to whom they might transfer the new shares. Whatever of value passed to the purchasers of those shares was withdrawn, not from the assets of the company, but from the antecedent equity or interest which was vested in the stockholders making the sale. Taking the stock transaction by itself, it did not affect the company in any way. It merely diminished the relative interest in the corporation of those stockholders who engaged in it. From them, therefore, and not from the corporation, the consideration moved which was effective in producing the money here in question. It was a consideration drawn out of capital stock, it is true, but not from the stock of the company.

To such a situation the words of Judge WALLACE in *Foster* vs. *Seymour*, 23 Fed. Rep., 66, are applicable:

> "The corporation lost nothing by the transaction disclosed by the bill except the paper which was created and called capital stock. None of its capital was diverted."

This Court is not asked by either party to base its judgment on the *form* of the transaction. It is practically conceded that the form was free from objection.

The petitioner undertakes to ask a judgment resting upon the inherent nature of the transaction as involving a depletion of the assets of the corporation. It clearly appears that such was not the nature of the transaction, but that if anything was depleted it was the value of the shares retained by the stockholder and which he held in his own individual right.

Regarded as a suit to recover the value of stock issued without consideration, the decision of this Court in *Scoville* vs. *Thayer*, 105 U. S., 143, affords a complete answer to the bill. In that case this Court said (p. 153):

> "The stock held by the defendant was evidenced by certificates of full-paid shares. It is conceded to have been the contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders and the fact was known to all. As between them and the company this was a perfectly valid agreement. It was not forbidden by the charter or by any law or public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter."

And in *Dickerman* vs. *Northern Trust Co.*, 176 U. S., 181, this Court said (pp. 202–3):

> "The very authorities which hold that the declaration that the stock is fully paid and non-assessable is not binding upon creditors also hold that the corporation cannot repudiate it, and proceed to collect either from the person receiving the stock or his transferee the unpaid part of the par value. * * * There is no doubt that if this were a suit by creditors to enforce payment of the unpaid portion of the stock subscription, the fact that the stock certificates declared that they were fully paid and non-assessable would be no defence; but it is a suit of stockholders in the right of the corporation, and as between the corporation and its stockholders the declaration that the shares are fully paid up and unassessable is a valid one."

IV.

The share stock, regardless of the time of issue, was the property of the individual shareholders and not of the corporation.

Underlying many of the arguments of the petitioner is the assumption that the shares of stock issued by a corporation are the property of the shareholders only in a qualified sense; that while they represent for the time being a certain relative interest in the assets of the corporation, yet such interest is subject to be diminished or otherwise dealt with through corporate action, in such manner as the officers and directors of the corporation may deem to be for its advantage.

This misconception explains the erroneous application of *Handley* vs. *Stutz*, 139 U. S., 417. Upon the authority of that case it is contended in substance that the Great Western Mining and Manufacturing Company had the power, without the consent of B. D. Harris, to take from him a part of his relative interest in the corporation represented by his shares of stock, and to sell it and apply the proceeds to its corporate purposes. In other words, it is argued that the corporation had the right to issue new stock to the purchasers of bonds; to receive for the bonds, accompanied by such stock, a larger price than could be obtained for the bonds alone, and to retain the entire proceeds to its own use.

It is further argued that because the corporation had this power, though it did not exercise it, therefore the estate of B. D. Harris should now be placed in the same position as though such power had been exercised.

Handley vs. *Stutz* will bear no such interpretation. It

is a case dealing with the liability of a creditor who received stock as a bonus upon the sale of bonds. The power of the corporation to issue such bonus stock, against the protest of any stockholder, was not considered, nor has it ever been determined by this Court that such power exists. In *Handley* vs. *Stutz* the transaction discussed was authorized by unanimous action of the stockholders, who voluntarily agreed to give up a part of their relative interest in the corporation in order to induce a purchase of bonds (139 U. S., 420).

The "bonus" referred to by this Court in *Dickerman* vs. *Northern Trust Co.*, 176 U. S., 202, did not come out of the treasury of the company but was provided by an individual out of stock which had been issued to him in payment for property.

In *Donald* vs. *American Smelting and Refining Co.*, 62 N. J. Eq., 729, it was held that a corporation of New Jersey, being a going concern, free from financial difficulties, could not, against the protest of a single stockholder, issue its stock at market value, when that was below par value, even though such a sale would be advantageous to the corporation. Still less could such a corporation issue stock as a "bonus" against the protest of any stockholder. Although the Court in deciding this case cited and relied upon the statutes of New Jersey, we see nothing in those statutes bearing on this question which differs from the general principles of law applicable to corporations.

The power to diminish the relative interest of each stockholder by the sale of new stock at par may or may not exist under the charter, and when it does exist of course

all the shares are subject to it. There are many decisions holding that a corporation, in disposing of an increased issue of stock, must give to each stockholder an opportunity to preserve his relative interest.

State *vs.* Smith, 48 Vt., 266.
Jones *vs.* Morrison, 31 Minn., 140.
Gray *vs.* Portland Bank, 3 Mass., 364.
Electric Co. *vs.* Edison Co., 200 Pa. St., 516.
Cook on Corporations, § 286, and cases cited.

But even though we should concede that a corporation may, indirectly, through the issue of "bonus" stock deprive its stockholders of a part of their relative interest in the corporation, it does not follow that it is bound to do so, or that the stockholders are bound to take the steps necessary to facilitate a deprivation of their property.

Nor does it follow that when a stockholder sells a part of his interest in the corporation, the latter can come down on him and claim the proceeds of the part sold because, by some procedure which it *might* have pursued but did not, the stockholder's interest could have been diminished to the same extent without yielding him any direct return.

Prima facie, at least, the stockholders' relative interest in the corporate assets is his individual property. So long, at least, as the corporation takes no action toward reducing such interest, his right of disposition is perfect and complete. If he sells it, or any part of it, he has an exclusive right to the proceeds. The possibility that his interest might have been relatively diminished before it was sold, does not place any cloud upon his title to the proceeds after a sale. As against any attempt by the corporation to diminish his interest, if he is not protected by the laws

of the land, at least he is protected to some extent by his own voting power.

Among the decisions which emphasize and illustrate the distinction between a stockholder's property in his shares of stock, and the corporation's property in its capital stock, we would cite:

Farrington *vs.* Tennessee, 95 U. S., 679, 686.

Foster *vs.* Seymour, 23 Fed. Rep., 65.

Taylor *vs.* South, &c., R. Co., 13 Fed. Rep., 152.

Hamor *vs.* Taylor-Rice Engineering Co., 84 Fed. Rep., 392.

Graydon *vs.* Graydon, 28 N. J. Eq., 229.

Christensen *vs.* Eno, 106 N. Y., 97.

Burrall *vs.* Bushwick Railroad Company, 75 N. Y., 211.

People *vs.* Coleman, 126 N. Y., 433.

In *Farrington* vs. *Tennessee*, 95 U. S., 679, Mr. Justice SWAYNE pointed out this distinction (pp. 686, 687):

> "The capital stock and the shares of the capital stock are distinct things. The capital stock is the money paid or authorized or required to be paid in as the basis of the business of the bank, and the means of conducting its operations. * * * The shares of the capital stock are usually represented by certificates. Every holder is a *cestui qui trust* to the extent of his ownership. The shares are held and may be bought and sold and taxed like other property. * * * The capital stock and the shares may both be taxed and it is not double taxation."

The distinction between capital stock and shares as objects of taxation has been the subject of many decisions to the same effect.

City of Memphis *vs.* Ensley, 65 Tenn., 553.

State Bank *vs.* Richmond, 79 Va., 113.

State *vs.* Traveler's Ins. Co., 73 Conn., 275.

Savings Bank *vs.* Burlington, 118 Ia., 84.
Illinois Nat. Bank *vs.* Kinsella, 201 Ill., 45.
People *vs.* Coleman, 126 N. Y., 433.
Western Union Telegraph Co. *vs.* Poe, 61 Fed. Rep., 449.

In *People* vs. *Coleman*, 126 N. Y., 433, Judge FINCH said (p. 437):

"The capital stock of a company is one thing; that of the shareholders is another and a different thing. That of the company is simply its capital, existing in money or property, or both; while that of the shareholders is representative, not merely of that existing and tangible capital, but also of surplus, of dividend-earning power, of franchise and the good will of an established and prosperous business. The capital stock of the company is owned and held by the company in its corporate character; the capital stock of the shareholders they own and hold in different proportions as individuals. The one belongs to the corporation; the other to the corporators."

In *Foster* vs. *Seymour*, 23 Fed. Rep., 65, Judge WALLACE said, in regard to a state of facts somewhat similar to those herein complained of (p. 66):

"The corporation lost nothing by the transaction disclosed by the bill, except the paper which was created and called capital stock. None of its capital was diverted. This scrip was not capital stock. The capital stock of a corporation is the money or property which is put into a corporate fund by those who subscribe for stock and thereby agree to become members of the corporate body."

In *Hamor* vs. *Rice-Taylor Engineering Company*, 84 Fed. Rep., 392, Judge BRADFORD, in discussing the right of a corporation to purchase its own shares, said (p. 396):

"In its substantial sense, the capital stock of a corporation is the fund of money or other property actually or potentially in its possession, derived or to be derived from the sale by it of shares of its stock or their exchange by it for property other than money. * * * The capital stock of a corporation widely differs in legal import from the aggre-

gate shares into which it is divided by the charter. While the former includes only the fund above described, the latter represent the totality of the corporate assets and property, and, directly or indirectly, the management of the affairs of the corporation. The stockholders have the right, according to their amount of stock, to participate in dividends declared, to vote at stockholders' meetings, and on the dissolution of the corporation, after all corporate indebtedness has been paid, to share between them the remaining assets. A corporation may own property far in excess of its capital stock, or it may, with property less than its prescribed capital, be engaged in a very prosperous business, and in either case the value of the shares may, in the aggregate, be a multiple of the capital stock. So, when the corporate assets are in excess of the capital stock, the shares, through unreasonable delay in declaring dividends or other mismanagement, may be less than par in value. The value of the shares in the hands of the stockholders, therefore, is no criterion of the value of the capital stock."

In *Taylor* vs. *South & North Alabama R. Co.*, 13 Fed. Rep., 152, upon a question of the application of the statute of limitations, it was held by Judge BRUCE (p. 161):

"It is a general principle that the property of a corporation is a trust fund for the benefit of the stockholders, in the hands of the corporate body, which is the trustee; but capital stock in the corporation, the certificate or evidence of which is in the hands of its owner, who has paid for it, is neither a trust fund, nor is its owner a trustee; and it is not perceived why statutes of repose do not run to protect the owner in his right to such property, the same as it would in reference to any other class of property."

In *Graydon's Executors* vs. *Graydon*, 23 N. J. Eq., 229, upon a question of construction of a will, Chancellor ZABRISKIE said (p. 233):

"Shares in the capital stock of corporations are neither money nor securities. They are simply the title of a shareholder to his proportion of the corporate property and its income."

In *Christensen* vs. *Eno*, 106 N. Y., 97, the question was whether the defendant should be held liable on stock

issued as a gratuity to certain stockholders who had been compelled to pay calls on their original subscriptions in excess of what was represented would be necessary at the commencement of the enterprise. The plaintiff sought to hold Eno liable, not on the ground of contract, but no the charge of depleting the capital of the corporation. Judge ANDREWS, delivering the opinion of the Court, said (pp. 100, 101):

> "The capital of a corporation consists of its funds, securities, credits and property, of whatever kind which it possesses. The word 'capital,' applied to corporations, is often used interchangeably with the words 'capital stock,' and both are frequently used to express the same thing—the property and assets of the corporation. * * * The unissued shares of a corporation are not assets. When issued they represent a proportionate interest in the shareholder in the corporate property—an interest, however, subordinate to the claims of creditors."

In *Burrall* vs. *Bushwick Railroad Company*, 75 N. Y., 211, in determining the sufficiency of a complaint upon demurrer, Judge FOLGER said (p. 216):

> "The phraseology of the complaint has been used in this particular, with an inexact notion of what is the capital stock of a business corporation, and what are the shares of that stock; though it would seem to be a matter that at this day should be well understood. A corporation cannot issue and deliver a share of its capital stock. By the joint action of the corporation and the subscriber for its stock, he may become the owner of a given number of shares thereof, but not in such sense as that he may take away those shares out of the common corporate fund. The capital stock is that money or property which is put into a single corporate fund by those who by subscription therefor become members of the corporate body. That fund becomes the property of the aggregate body only. A share of the capital stock is the right to partake, according to the amount put into the fund, of the surplus profits of the corporation; and ultimately, on the dissolution of it, of so much of the fund thus created as remains unimpaired, and is not liable for debts of the corporation. * * * Those shares are intangible and rest in abstract legal contemplation. It has been said that they are not a species of property

that can be transferred by delivery; and that the assent of the owner to part with it must be expressed in writing."

It was in accordance with the spirit of these decisions that the Great Western Mining and Manufacturing Company, in the whole course of this transaction, recognized the principle that the interest or property which its shareholders had in the corporate assets, however represented, was not in itself an asset of the corporation. There was a particular reason why that principle should be recognized by this corporation, since twice before, through disregard of it, trouble had arisen.

(*a*) In 1863, there being a proposition pending for the purchase of all the stock of the corporation, the board of directors undertook to deal with it as a corporate matter, and to lay down rules as to the security to be required from the purchaser (Rec., 302). The board was compelled to recede from this position and to recognize the right of each stockholder to dispose of his stock as he saw fit.

(*b*) In 1883 an attempt was made to induce the stockholders to surrender, ratably, one half their stock,so that the relinquished stock might be sold to provide working capital (Rec., 330). The stockholders not consenting, the project failed.

In the light of these precedents it was a settled principle, so far so the Great Western Mining and Manufacturing Company was concerned, that the shares of stock were the exclusive property of the shareholders.

If the contrary view be taken, to the extent necessary to support this bill, it must be held that the corporation's right to appropriate the proceeds of a sale of stock is

(1) A right capable of exercise against each stock-

holder, irrespective of the treatment accorded to other stockholders.

(2) A right independent of the amount of stock sold, extending to a sale of the whole as well as of a fraction.

(3) A right inhering in the company and not in its creditors, capable of exercise in times of prosperity as well as of adversity.

In other words, the principle relied on by the petitioner, if it be valid at all, must go to the point of holding that if B. D. Harris, in 1889, had seen fit to sell his entire interest in this mining company, it would have been the right of the company (then a solvent, going concern in the full tide of prosperity) to have taken from him the entire proceeds of the sale; while leaving G. D. Harris, for example, in undisturbed possession of his shares, with full power to dispose of them and apply the proceeds to his own use.

V.

The fact that bonds and stock were sold through a common agent to the same purchasers, did not injure the corporation, provided the proceeds were fairly divided.

The petitioner seems inclined to qualify the broad claim presented in the bill, somewhat as follows:

> "The shareholder may have a right to his shares, and also to their proceeds, if he sells them in a legal and proper way; but if he sells them illegally or improperly, the proceeds do not belong to him, but to the corporation which issued the certificates."

We are not quoting his words, but stating what we understand to be one phase of his contention.

Inasmuch as there are several specifications of improper conduct in regard to the sale of the shares, we will take up first the objection that it was improper to sell them through the same agent that was selected by the corporation for the sale of its bonds.

The certificates for shares of stock authorized by vote of the stockholders in 1889 were not actually issued and delivered until after a new stock book had been obtained (Rec., 276). The right to receive such certificates, however, accrued immediately upon passage of the necessary resolutions by the stockholders and directors, and the stock must be deemed in existence from that time for every corporate purpose.

Tustone *vs.* Frankfort Bridge Co., 2 Bibb, 576.

Drury *vs.* McCracken, 14 Ky. Law Rep., 208.

Chester Glass Co. *vs.* Dewey, 16 Mass., 94.

There was, at that time, no definite plan for furnishing stock to sell in connection with the bonds. The manner in which that came to be provided for is described by John Carlisle as follows (Rec., 104):

"The way that the stock was obtained for that purpose was by getting the consent of all the stockholders to sell to the bondholders so much stock *pro rata* according to their holdings at fifty cents on the dollar. At that time the Mr. Harrises were holding the majority of the stock and I requested them to furnish it all, because I felt the stock was worth a good deal more than that and I did not care about letting mine go. They declined to furnish it all; they would only furnish their proportion of it, and all the stockholders agreed to do the same; an agreement of that kind in writing was made and given to the company."

At page 116 he testified:

"Q. How did you arrive at the valuation of 50 cents a share of the stock contributed?

A. That is what we agreed to take for our stock; we considered that we were giving away 50 per cent. more.

Q. How did you arrive at the amount, 50 cents on the dollar, do you remember?

A. It was just simply an agreement, we would sell at 50 cents on the dollar for that purpose, thereby giving up one-half of the value of the stock."

The transaction may very likely have shaped itself in their minds at that time as a sale of stock to the company, to be used by it to induce a purchase of bonds. Whether such a sale would be lawful or not is a question which will be separately discussed hereafter. It makes very little difference, for the transaction did not take that form.

On April 27, John Carlisle wrote to B. D. Harris (Rec., 274):

"I also enclose a proposition of the stockholders, which Mr. Tyler carefully prepared so that we could legally take the $75,000. The company cannot legally buy its own stock and reissue it. If bought by the company it must be cancelled.

If you approve, please sign and have your brother sign, and return to me, when we will sign it, then I shall have a meeting of the board here and accept the proposition."

The proposition referred to is the one already quoted at length (*supra*, p. 18), whereby John Carlisle was constituted an agent of the company for the sale of bonds and an agent of the stockholders for the sale of stock, and provision was made for dividing the gross returns between the bonds and the stock in such a way as to make payment for the stock at 50 cents on the dollar.

This proposition, while in form made by the stockholders to the company, was in fact prepared by the attorney for the company and laid before the stockholders by the agent

whom the company had appointed to find a market for its bonds.

The foregoing arguments have made it clear, we trust, that Mr. Harris was under no legal or moral obligation to accept this proposition. He might have kept his shares and his interest in the company would have remained just what it had always been. He might have sold his shares to an outsider and, unless some very novel view as to the relation between a corporation and its stockholders is to obtain, he would have had a right to the proceeds. Why, then, was he not free to accept this proposition if he deemed it beneficial to the corporation? It was placed before him by his associates who had studied the situation, as being the best course to pursue to enable the corporation to float its bonds. It appears to us that he was free to accept or to reject it.

That his acceptance of the proposition was not inspired by any doubt as to the future of the company or the value of its shares is evident, not only from his refusal to part with more than his proportionate amount of the stock(Rec.,104), but also from his letter of April 27, 1889 (Rec.,274),written just before this proposition was received. In it he says:

> "Elliott, too, I notice, asks for the value of the coal lands we own. It seems to me a proper standard, or comparison, can be found in the Youghiogheny coal district, where land having coal deposits similar in quality to ours, and certainly of no better quality, sells readily for $150 to $500 per acre, according to location, either near or remote from railroad transportation, and we certainly have the advantage over Pennsylvania mines in cheapness of mining and in nearness and certainty of market; in other words, we can make money (where we have perfected facilities for handling our coal) at prices that would run the Youghiogheny mines in debt, and we can reach Cincinnati and down-river markets in low water and during coal famine and high prices when they can not."

The question of the *motive* for selling the stock is wholly immaterial. If the stock was his in such a sense that he was entitled to the proceeds if he sold for a good motive, why was he not also entitled to the proceeds if he sold it with a bad motive or by an irregular method?

The *gist of the im*propriety charged by the petitioner in this transaction appears to lie in the fact that the stock and bonds were sold through a common agent and to the same purchasers. If sold through a common agent to different purchasers, the alleged impropriety would not exist. Or, if sold to the same purchasers, but through different agents, the objection would be removed. This criticism on the mode of sale appears to us to be purely fanciful. Even if there were any impropriety in such a method of sale, it does not appear that the interests of the corporation were sacrificed.

The evidence in this case indicates that the bonds and stocks of this mining corporation, when offered for sale together, found a better market than if they were offered separately (Rec.,20). Why should the corporation and its stockholders, if willing to sell both bonds and stock, be bound to incur the loss which would result from offering them for sale separately, contrary to the requirements of the market? Such a course would merely give an opportunity to some middleman to pick them both up at a diminished price and, by combining his purchases, to reap a profit. What principle of law or of morality forbade these parties to appropriate the middleman's profit to themselves, by offering their property for sale in the first instance according to the method which the demands of the market rendered most advantageous?

If the bonds and stock were separately owned by strangers who merely happened to learn, through a broker, of the advantage of pooling their biddings, their right to adopt such a method of selling their property would be unquestioned. If such a contract may be made between strangers, why may it not fairly be made between a corporation and its shareholders? There is no such relation between a stockholder and his corporation as forbids their co-operating freely in any transaction which they may deem advantageous for their several interests.

Stratton *vs.* Allen, 16 N. J. Eq., 229.
Wausan Boom Co. *vs.* Plumer, 35 Wis., 274.
Memphis, &c., R. Co. *vs.* Dow, 19 Fed., 388.

In *Farmers' L. & T. Co.* vs. *Chicago, &c., R. Co.*, 163 U. S., 31, this Court said (p. 44):

> "We do not understand that a stockholder is under obligations, legal or moral, to sacrifice his personal interests in order to secure the welfare of the corporation of which he is a stockholder, or to enable another stockholder to make gains and profits."

A fortiori, it follows that a stockholder is not bound to sacrifice his personal interests in order to embarrass the corporation by rendering the exercise of its corporate powers more difficult and circuitous.

VI.

There was a fair division of the proceeds of sale as between the bonds and stock.

No attempt was made to show by evidence that the division of the proceeds of sale was not fair, according to actual values at the time. There was proof of unsuccessful efforts to float the bonds, separately, so as to net the company 60 or 65 (Rec., 117, 118). There was also proof that the earnings of the company were sufficient to pay 4 per cent. dividends on the stock (Rec., 20). The Circuit Court found affirmatively that the division was in accordance with actual values (Rec., 190).

At first sight it would seem improbable that if the bonds of a company were only worth 60, its stock could have any value at all. This view is one which ignores the speculative and uncertain character of a mining venture.

The characteristic feature of mining stock is that the possibility of loss is limited, while the possibilities of profit are practically unlimited. If the views confidently expressed by Mr. Harris in his letter of April 27, 1889 (Rec., 274) were right this stock was worth over $1,000 a share. Time alone could tell whether his views were correct.

If there was only one chance in ten that the stock would attain that value and if all the other chances represented complete failure, still the stock was fairly worth par.

In the case of bonds, on the other hand, the possibility of profit is limited to the rate of interest reserved, enhanced by the discount at which the bond is sold, while the possibility of loss extends to the whole amount in-

vested. Bonds of a mining company which had nine chances out of ten of proving a complete failure would not even be worth sixty.

A coal mine does not involve the same degree of risk as a gold mine, nor is it as secure as a railroad. It occupies an intermediate position. In the case of the Great Western Mining and Manufacturing Company, selling a twenty-year six per cent. bond at 60 meant borrowing money at the rate of about 11 per cent. per annum. That enhancement of the rate of interest represented the premium which an investor would exact for the risk to which his capital was exposed.

Selling stock of the same company at 50 might mean either that in the mind of the purchaser there was more than an even chance that the company would, during a long period of years, earn ordinary dividends on its nominal capital; or it might mean that in the purchaser's judgment there was a better chance than one in ten that it would earn dividends on five times its nominal capital. In the former case the bonds would be a reasonably safe investment; in the latter case they would be an extremely hazardous investment.

There is, therefore, nothing abnormal or indicative of bad faith about the division of the proceeds agreed upon, as between bonds and stocks.

VII.

The bill is not sustainable on the ground that Elliott, Johnson & Co. were deceived.

(a) No such issue has ever been tried.

Elliott, Johnson & Co. are not mentioned in the bill, nor is there any charge of deceit in the bill. It is entirely consistent with the bill to suppose that they knew of all that the stockholders did or intended to do. Whether they did have such knowledge is an issue that has never been tried, because it has never been presented by the pleadings. Henry P. Scott, the only witness who could have shed any light on the question, was not cross-examined (Rec., 25), because the material portions of the bill which his testimony was intended to support were admitted by the answer.

When fraud is relied upon as a ground of liability it should be pleaded. When not relied on as a ground of liability it should not be dragged into a case to obscure the real issue.

Moss *vs.* Riddle, 5 Cranch., 351, 357.
Moore *vs.* Greene, 19 How., 69, 72.
Voorhees *vs.* Bonesteel, 16 Wall., 16, 29.
Beaubien *vs.* Beaubien, 23 How., 190, 208.
Bartol *vs.* Walton & Whaun Co., 92 Fed. Rep., 13.

(b) Elliott Johnson & Co. had no interest in the matter beyond earning their commissions.

Elliott, Johnson & Co. purchased no bonds or stock (Rec., 237); declined to assume any responsibility (Rec., 233); merely put the bonds out over their name and took

their commission partly in cash and partly in stock (Rec., 236). By the subsequent insolvency of the company they may have incurred criticism, but it does not appear that they sustained any pecuniary loss.

The receiver would not be authorized to pay over to them any part of any judgment which he might recover in this suit. The proceeds of such a judgment would become part of the general assets of the corporation for distribution to creditors.

No judgment in this suit could have the effect of barring any claim of Elliott, Johnson & Co. which they might choose to assert in their own name. There is no privity between them and the complainant.

(c) There was no deception in fact.

The evidence shows that Elliott, Johnson & Co. dealt exclusively with John Carlisle. All their correspondence prior to June, 1889, was addressed to him individually and not in an official capacity (Rec., 233–9). They never asked him whom he represented. They knew that the stock sent them for delivery to their customers was stock which had been issued to stockholders to represent surplus earnings invested in improvements (Rec., 23). They knew that it had to be transferred on the books of the company by someone, as attorney for the stockholders, into the names of their customers (Rec., 244 *et seq.*). They recognized, in making their remittances, that the moneys sent to John Carlisle were the proceeds both of stock and of bonds (Rec., 240 *et seq.*). They made no inquiry as to the compensation which the stockholders received for the surrender of their stock (Rec., 23). Their only reliance was on their "understanding" that the

company was to have the benefit of the *proceeds of the bonds*. Mr. Scott's testimony on this subject at page 23 of the record is as follows:

"Q. Was anything said by Mr. Carlisle, or any representative of the Great Western Mining and Manufacturing Company, as to the source from which would come this bonus—the fifty per cent. of stock which was to accompany the bonds?

A. Yes. I made very careful inquiries, desiring that the stock should be issued as full paid and properly issued. Mr. Carlisle stated to me that they could increase their capital by the one hundred and fifty thousand dollars desired, very readily, because the surplus earnings of the company, properly belonging to the stockholders, for many years, had been put back into the company for betterments, and that stock could be properly and legally issued in lieu of such expenditure.

Q. And was anything said as to who was to contribute this stock in the sale of the bonds, whether it was company, stockholder or otherwise?

A. I have no recollection of the legal means that were to be employed in getting the stock out properly, but it was to be stock that belonged to the company, and we were not buying bonds or stock alone, but both.

Q. From whom?

A. From the company.

Q. Was anything said to you by Mr. Carlisle or any other representative of the company about the fact that these stockholders were selling, or were to sell, this stock, one hundred and fifty thousand dollars' worth, to the company, or that the company were to pay the stockholders therefor?

A. I do not know how they proposed to get it out, whether it was to be issued as dividends and then given by the stockholders to the company or not; but I never had the slightest notion that a dollar of the proceeds of the bonds was to be taken out of the company for any individual's use. Every penny, according to our understanding, was to be left for the company uses after the payment of the debts of the company."

This testimony would not support any charge of false representation against Mr. Carlisle, in respect to the division of the proceeds of the sale between bonds and stock. It is not charged that he made any false state-

ment on this subject. At most he merely omitted to inform the brokers, Elliott, Johnson & Co., of the details of their principal's business; details regarding which they made no inquiry, and of which they as brokers had no right to be informed, either by any rule of law or by the customs of their profession.

Nor does it appear that Mr. Scott's "understanding," however arrived at, involved any error of fact. The "proceeds of the bonds" never were taken out of the company for any individual's use, except in payment of debts. Mr. Scott knew full well that the moneys remitted were the proceeds both of bonds and of stock, and he nowhere testifies to any understanding that they were all to be regarded as proceeds of bonds. On the contrary, he expressly says that he never knew whether the company got the stock from the stockholders by gift or otherwise.

The petitioner bases his claim that Elliott, Johnson & Co. were deceived mainly on certain correspondence in which the words "bonus stock" are used, and also upon John Carlisle's letter of April 27, 1889.

This letter (Rec., 258) was written at a time when, according to the way in which both parties viewed the transaction, the company was acquiring its own stock for the purpose of delivery in connection with bonds. The conception of a simultaneous sale through John Carlisle as a common agent had not yet been evolved. The letter of acceptance was intended to give assent to the proposition embodied in Elliott, Johnson & Co's letter of April 18, 1889 (Rec., 233), to which it expressly refers. Taking the two letters together, it is perfectly clear that the proposition which was made and accepted was that

Elliott, Johnson & Co. should undertake to float, for the company, bonds accompanied by 50 per cent. of their par in stock, in such manner as to net the company therefor an amount equal to 85 per cent. of the par of the bonds; Elliott, Johnson & Co. to retain for themselves everything above that amount. The 85 per cent. was to be net to the company for the bonds and stock, but there was no condition imposed as to how the company was to get the stock, or how much it should pay for it.

The petitioner attempts to imply from the word "bonus," frequently used in the correspondence and testimony, an agreement or representation that the stock was to cost the company nothing. No such meaning attaches to the word by usage or authority. On the contrary, in the great majority of cases where the word is used, the context makes it manifest that the "bonus" does cost something to the person who furnishes it.

In *Kenicott* vs. *Supervisors*, 16 Wall., 452, 471, this Court approved the definition of Webster:

> "A premium given for a loan or a charter or other privilege granted to a company; as, the bank paid a bonus for its charter; a sum paid in addition to a stated compensation."

And Mr. Justice HUNT added:

> "It is not a gift or a gratuity, but a sum paid for services, or upon a consideration in addition to or in excess of that which would ordinarily be given."

So in *Dickerman* vs. *Northern Trust Company*, 176 U. S., 181, 202, this Court said:

> "And if it were necessary to the negotiation of the bonds to give a bonus in stock, it cannot be considered in the light of a mere donation."

In *Commonwealth* vs. *Erie & W. Transportation Co.*,

107 Pa. St., 115, the Supreme Court of Pennsylvania said:

"The idea of a consideration is always present when we speak of a bonus."

See also

Consolidated Bank *vs.* State of Louisiana, 5 La. Ann., 57.

Railroad Company *vs.* Maryland, 21 Wall., 456, 473.

Leslie *vs.* Leslie, 50 N. J. Eq., 103.

These authorities show conclusively that there is no basis for the idea that the use of the word "bonus" implies that the subject-matter so designated is to be taken as without value for the purposes of the particular transaction.

Suppose there had been a proposition to give with the bonds a "bonus" in stock of the Chattaroi Railroad Company. Would anyone have been justified in assuming that the Great Western Mining & Manufacting Company undertook to obtain that stock for nothing? If anyone was interested in knowing, and had a right to know, how much of the total consideration paid was to go into the treasury of the Coal Company for its corporate uses, and how much was to go to pay for stock of the Railroad Company, would he not be bound to make the inquiry?

The same principles apply here. Elliott, Johnson & Co. did not take the trouble to enquire into the nature of the arrangement by which stock was furnished them for delivery to their customers. They had, as a matter of fact, no concern with it, unless some of their customers asked for the information which does not appear to have been

the case. It is too late, after the lapse of several years and a complete change of conditions, for them to discover that they were "deceived" about something which at the time was not deemed worthy of a thought or a question.

(d) B. D. Harris never had any communication with Elliott, Johnson & Co. except of the most general nature.

Mr. Scott testified as follows (Rec. 21):

"Q. Did you have interviews with, or communications or data from, parties other than Carlisle representing that company?

A. None whatever, my recollection is, until after the terms had been agreed upon and the investigation was made, and then I met Mr. B. D. Harris once in New York and once in Philadelphia.

Q. Did you meet him prior to the final closing of the negotiations or after they were closed?

A. Subsequent to the closing of the negotiations, and my recollection is that there was no conversation with him except of a general nature and particularly referring to a request we had made, that the company, or several of the individuals associated with the company, should form a small pool to support the securities to be sold after they were listed on the Baltimore stock exchange."

It is probably true that John Carlisle sent to Mr. Harris a copy of his letter to Elliott, Johnson & Co., of April 27, 1899 (Rec., 274), but there is nothing to show that B. D. Harris ever approved of the letter, or that he understood it as introducing any new element not stated in Elliott, Johnson & Co.'s letter of April 18, 1889. Only a few days later John Carlisle writes (Rec., 276):

"Tyler and I worked over those papers constantly for a week and I felt certain you would approve them, but as two heads are better than one, naturally three heads are better than two, and I fear Tyler and I have made some mistake."

John Carlisle was not a general agent for Mr. Harris. He had no authority whatever to represent him except his

written authority to sell stock at 50 in connection with bonds. He had no power to make any representation or create any estoppel that would deprive Mr. Harris of his stock or its proceeds.

If John Carlisle had any general authority to represent any one except himself, it was that attaching to his office as secretary and treasurer of the company. He certainly could not create a cause of action in favor of the company by making false representations in its name and for its benefit. If the company could not sell its bonds without representing falsely that it was entitled to retain the proceeds of stock which went with the bonds, then it ought to have refrained from selling bonds. By no sort of ethical jugglery could the corporation be justified in first making the false representation and then calling on B. D. Harris to make it good.

VIII.

The bill is not sustainable on the ground that purchasers of bonds and stock from Elliott, Johnson & Co. were deceived.

At some stage of this argument we expect to find the petitioner taking the position that the deception charged to have been practiced on the purchasers of bonds and stocks is the one vital and essential element of his cause of action.

We expect to hear it contended that whether the stock in question was issued with or without consideration, and whether the method pursued in selling it was regular or

irregular, if the purpose and effect of the proceeding was to deceive the purchasers of bonds and stock, then the complainant is entitled to relief against the defendants. And we expect to hear it admitted that if those purchasers were not in fact deceived, then there is nothing in the circumstances under which the stock was issued or the manner in which it was transferred which gives any just ground of complaint to the petitioner.

When that stage is reached we desire the Court to observe that the whole burden of the complaint has been shifted upon a single fact which is not alleged in the bill nor mentioned in the proofs, andwhich involves no wrong or damage to the complainant, as receiver, or to the corporation in whose name he sues.

We believe we can show the Court, furthermore, that it was extremely unlikely for any such deception to occur, and that if it did occur it was practically impossible for defendants' testator to have had any knowledge of it or participation in it.

(a) No such issue has ever been tried.

The petition for leave to begin the suit is silent on the point (Rec., 365–6). It goes upon the theory that "certain stockholders and officers" issued stock to themselves gratuitously and immediately sold it to the corporation for cash "as a mere device or instrumentality to abstract said moneys from the treasury of said company." So far from alleging that there was any deception practiced upon purchasers of the stock from the company, *it fails to disclose that there were any such purchasers.*

The bill of complaint goes a little further. It shows that there were purchasers, but does not even hint at any fraud

or deception practiced upon them. The only allegation about the sale is the following (Rec., 4, 5):

> "That thereafter said negotiations for the sale of said bonds were successful, and said bonds were sold for a net price of eighty-five cents on the dollar; that the proposition of sale included a bonus of fifty per cent. of the par value, that is to say, that a purchaser of a bond for $1,000 was entitled to have with said bond capital stock of said company at its par value; that is to say, that a purchaser of a bond for $1,000 was entitled to have with said bond capital stock of said company in the sum of $500; and that thereupon the arrangement was made, in pursuance and as a part of the combination hereinbefore alleged, by the said board of directors and the said stockholders of said company with themselves, whereby said fifty per cent., a bonus of stock, was furnished to said company to fulfill the aforesaid contract for the sale of said bonds, the said directors and stockholders as aforesaid furnishing said capital stock to said company as aforesaid at fifty cents on the dollar of the face value thereof; that the money with which said directors and stockholders were paid on account of said stock was taken by them out of the proceeds of the sale of said bonds."

It would be entirely consistent with the case alleged in the bill if it should turn out to be the fact that all the bonds and stock therein referred to as sold *were purchased by B. D. Harris himself!*

Of course, we do not assert that he was or was not the purchaser. But the failure of the bill to exclude such a hypothesis illustrates in a striking manner the fact that it was not intended to allege, and did not allege, anything whatever about the identity, rights, interests, knowledge or belief of the purchasers.

(b) There is no evidence that any purchasers were deceived.

There is not a word of direct evidence upon the subject now under discussion. Every opportunity to produce such evidence seems to have been shunned by the petitioner. The complainant's witness Scott must have had

personal knowledge as to what representations were made to purchasers. He was not asked a single question along that line (Rec., 18 to 25). It appeared that a printed statement was gotten up with great care and widely distributed, for the purpose of presenting the merits of these bonds and stocks to possible purchasers (Rec., 235, 238). A copy of it was certainly obtainable, and it would have shown very clearly on what grounds purchasers were asked to invest. No copy of this circular was offered in evidence.

At the close of the hearing the complainant's counsel was given a fresh opportunity to formulate the grounds upon which he asked for judgment (Rec., 193). He did formulate his demands with great minuteness, but did not hint at any such ground of liability as is now claimed. There is nothing in the opinion of the learned Circuit Court to indicate that any such claim was called to its attention.

The assignment of errors filed by the complainant (Rec., 195) contains not a word on this phase of the case, and the same is true of the additional assignment of errors filed two months later (Rec., 199).

It is manifest from the record that the whole idea of a fraud practiced upon the purchasers of bonds and stock is an afterthought. An examination of some of the decisions relied on by the petitioner will show how strong was the temptation to inject some such new element into the case in order to afford a color of justification for citing those decisions.

The point was first raised in the Circuit Court of Appeals, and that Court held that there was no evidence of any such deceit as was charged (Rec., 397).

(c) It is extremely improbable that any deception occurred.

In his petition for the writ of certiorari (p. 30) the petitioner asserts, in effect, that no imagination is required to reach the conclusion that if the purchasers of bonds and stocks had known that the directors of the company intended to take $75,000 of the proceeds of the sale in payment for their stock, the purchasers would have refused to make the purchase.

Such a conclusion certainly cannot be reached by any intellectual process. It is a bare assumption of a disputable proposition of fact, which not only has never been tried, but is contrary to all the probabilities of the case. B. D. Harris himself, in 1883, bought bonds and stock of this company without requiring that the proceeds of the stock should go into the treasury of the company. What he was willing to do in 1883, when the fortunes of the company were at their lowest ebb, others may have been willing to do in 1889, when a good dividend on the stock was being earned and paid.

A man who buys bonds or stocks of a going concern, which has been in business for years, does not ordinarily enquire whether he is buying direct from the company or from some intermediate holder. If he purchases from a dealer in investment securities he usually assumes that the latter is the vendor. Rarely, indeed, does he ask the question, Will this money which I am now paying go into the treasury of the company?

We are far from denying that such a question is proper, if he sees fit to ask it. A prospective purchaser has a right to refrain from purchasing, and that carries with it the right to ask any question he chooses before purchas-

ing. Nor do we intend to deny that a false statement in respect to the ownership of stock which is offered for sale would constitute fraud. For many obvious reasons such a statement is material. A purchaser, deceived on such a point, might undoubtedly rescind the contract or sue for damages. It does not appear that any of the purchasers of this stock ever did rescind or ever did sue for damages, and that is an additional reason for believing that none of them were deceived.

If any deception was practiced it must have been by Elliott, Johnson & Company, consciously or unconsciously. They alone were in communication with the purchasers. They knew that the stock transferred to their customers' names had been the property of individual shareholders, and they did not know the nature of the arrangement with the company pursuant to which it was delivered (Rec., 23). If they asserted to their customers that they did know, when in fact they did not know, they were guilty of a direct falsehood. Such conduct on the part of a reputable banking house is not to be assumed on mere suspicion.

It should be remembered that Elliott, Johnson & Company were not in a position to assure their customers, even by inadvertence, that the price paid for bonds and stock went into the treasury of the company. Their plan was to sell the bonds at 95 with a bonus of 25 per cent. in stock (Rec., 236). The evidence shows that they did this with substantial uniformity (Rec., 242, 247). They accounted to the company on the basis of 85 for the bonds with a bonus of 50 per cent. in stock (Rec., 233). In other words, they took profits more nearly resembling those of

underwriters than an ordinary broker's commission, although they expressly refused to accept the responsibility of an underwriter (Rec., 233, 234). It was, of course, impossible for them to assert to their customers that the entire price paid went into the treasury of the company, and it was equally impossible for them to attempt to say what part of the price went to the company without disclosing their own profit, which it is to be assumed they would be very loath to do.

The record indicates that, in selling the bonds and stock, they relied chiefly on the value of the lands, the quality of the coal, the facilities for marketing it, the cost of mining, and the record of net earnings (Rec., 235, 238, 260, 261, 262, 275, 277, 285).

(d) Even if a promise was made to use the proceeds of sale in a particular way, that did not impress the proceeds with a trust.

The petitioner's argument appears to proceed in part upon the theory that if there was a promise on the part of the corporation to use the proceeds of sale of bonds and stock only for the improvement of its property, it would constitute a breach of trust for the corporation to use such proceeds in any other manner. This is contrary to the well-considered decision of Judge WALLACE in

Banque Franco-Egyptienne *vs.* Brown, 34 Fed. Rep., 162.

If it is intended to create a trust there are, of course, many legal and effective ways of doing it; but a mere promise or representation as to the use to be made of money will not have this effect. In the case cited Judge WALLACE said (p. 196):

"If a borrower refuses to keep his agreement with the lender to use

the money borrowed in a particular way, the lender has his remedy at law for breach of contract, or, in an appropriate case, may have relief in equity and compel specific performance. But there is no principle of equity which allows him to pursue the money as a trust fund when the borrower has parted with it to another who has obtained title to it as between himself and the borrower. Even where money has been obtained by deceit, so that in judgment of law the contract of loan is voidable as between the lender and borrower, it cannot be followed by the lender into the hands of one who has received it innocently and with a right to retain it as against the borrower."

In this case the money received for the stock never came into the possession of the corporation. It passed through the hands of John Carlisle, the common agent, directly into the possession of B. D. Harris, who furnished the stock for delivery. The possession of Carlisle, as agent, was the possession of his principals. As to so much of the money as represented bonds, his possession was that of the corporation; as to so much as represented stock, his possession was that of those who furnished the stock.

A promise by the corporation to its creditors that it would get possession of the money of B. D. Harris, and apply it to the improvement of its property, would not impress a trust upon the money in the hands of Harris, or of Carlisle, his agent.

Suppose John Carlisle, after receiving the money, had omitted (pending the advice of counsel) to turn over that part of it which represented stock furnished by B. D. Harris. Suppose B. D. Harris had sued him for it. What defence could he have urged? Entrusted with the possession of stock for sale, he reports the stock as sold and then withholds the proceeds. Could he excuse that sort of conduct on the ground that a question existed

as to the title to the stock, or the illegality of the arrangement, or dishonesty in the method of conducting the sale? Certainly not. Regardless of all such questions the law would have sustained B. D. Harris in saying to his agent, My money or my stock.

Would not the same thing be true if the stock had been delivered to the corporation for the purpose of enabling it to fulfill its contract to furnish a bonus of stock with the bonds? Assuming that such an arrangement was *ultra vires* (although we shall presently show that it was not), could the corporation make use of it to deprive B. D. Harris both of his stock and of the money received for it? Could it justify such a position on the ground that it had made a promise to apply the money in some other way?

By the sale of this stock, in order to enable the corporation to float its bonds, Mr. Harris and his brother lost their voting control of this company. No court can speculate on the question of the extent to which they were prejudiced by such loss of control. Had they retained control *non constat* but that the insolvency might have been avoided. It is not now possible to restore the *status quo*, nor is any offer made to do anything of that sort. If the money agreed upon as representing the value of the stock had been turned into the treasury of the corporation, and B. D. Harris were now presenting a claim for that money, we do not see how the claim could be resisted.

(c) The judgment, if any, recovered by the complainant in this case would not enure to the benefit of those who were deceived.

The cause of action herein is no part of the mortgaged

property. Hence, if anything should be recovered by the receiver, it would be part of the general assets of the corporation, to be equally distributed among all creditors. A glance at the schedules (Rec., 383, 373, 369) will show that many of them are persons having no concern at all with the matter now under discussion. Of the persons who originally bought bonds and stock, there is no way of telling how many continued to be creditors up to the time of the commencement of this suit or the appointment of the receiver. If they sold their bonds, no right of action for deceit or breach of contract would pass with the bonds. Of those who still retain their bonds it is impossible to say how many had actual knowledge of the facts, how many were indifferent to the disposition of the price paid, and how many were actually deceived, if there was any deception, which we, of course, do not admit.

If the complainant receiver should recover judgment on such a ground, he could not go to the Court which appointed him and say, "I brought suit, as directed, for assets fraudulently abstracted from the treasury of the Great Western Mining and Manufacturing Company. I happened to obtain a judgment which was designed to give relief for deceit practiced in 1889 upon A., B., C. and D. by the corporation which I represented. Permit me, therefore, to distribute these moneys among A., B., C. and D. according to their respective rights." Would not the Court be apt to reply, "You are not a receiver for A., B., C. or D; the judgment which you have obtained does not bar them from any right or remedy which belongs to them at law or in equity, nor will it protect

the defendant against their demands, if any they have. The money which a lucky chance has brought into your possession must be distributed as are the other assets of your receivership."

(f) If any fraud was committed, defendants' testator had no part in it.

There is no pretense that B. D. Harris ever had any communication with the purchasers of bonds and stocks (other than himself) or that he ever assented to any such communication, other than that contained in the printed circular which the complainant did not see fit to put in evidence. He entrusted the sale of his stock to competent and reputable brokers, furnished them truthfully with all the information they asked, and relied on them to make no statements of fact which they did not know to be true.

Under these circumstances the false and unauthorized representations of his agent would not deprive him of title to his property or its proceeds.

Greene *vs.* Dockendorf, 13 Minn., 70.

If such representations were made to induce a sale, their falsity might warrant a rescission of the contract; but, if unauthorized, they could expose the principal to no personal liability.

Decker *vs.* Fredericks, 47 N. J. L., 469.
Concord Bank *vs.* Gregg, 14 N. H., 331.
Herring *vs.* Skaggs, 62 Ala., 180.

It is within the scope of an agent's authority to describe the quantity, quality or condition of that which is entrusted to him for sale, but not to disparage or deny

his principal's title or make promises as to what will be done with the proceeds of sale.

(g) If any fraud was committed, it was not injurious to the corporation.

According to the evidence, the bonds could not be floated unless accompanied by stock (Rec., 20). According to the petitioner, the bonds and stock together could not be sold unless the purchasers believed that the stock was costing the company nothing and that the entire consideration was going into the property to enhance the security for the bonds. The company could not get the stock for nothing, because the stockholders would not give it up on those terms. According to the petitioner's most recent view of the case, then, some sort of false representation was absolutely necessary in order to enable the company to sell its bonds.

Assuming that a fraud was committed and that the bonds were sold in consequence of it, how was that an injury to the corporation? Was the company injured because the sale of its bonds was facilitated? The power to borrow money was one of its corporate powers, and presumably everything which enabled the company to exercise its corporate powers more freely and effectually was for its benefit. The company was well able to pay interest on its bonds. In the first half of 1889 it earned more than twice the amount necessary for this purpose (Rec., 295). Yet, if it had been unable to sell its bonds it might have been wiped out, or its business greatly injured, through the enforcement of its floating debt. It would seem that if any fraudulent misrepresentation took place, the Great Western Mining and Manufacturing Company should be the last to complain of it.

The theory of the complainant seems to be that John Carlisle represented to Elliott, Johnson & Company (and through them to the purchasers of the bonds and stock) that the entire proceeds of sale of stock as well as of bonds were to go into the treasury of the corporation for corporate purposes; that B. D. Harris authorized or ratified such a representation and is responsible for keeping it good, and that consequently the corporation can sue Mr. Harris to compel him to put into its treasury the moneys which his agent represented were to go there.

Some of the errors of fact and of law which vitiate this claim have been pointed out in the foregoing argument. We desire now to direct the attention of the Court to the absurdity of the claim that the corporation can compel Mr. Harris to make good a representation made in the course of a transaction to which it was not a party and upon the faith of which it never acted.

The bare statement of such a proposition seems to eliminate it from the discussion. It scarcely seems credible that a suit in equity was ever brought upon such a basis, and it will be remembered that it was not upon any such basis that this suit was authorized to be brought by the Circuit Court for the District of Kentucky. An examination of the books, however, discloses a limited number of cases in which claims of a somewhat similar character to that above stated have been entertained by the courts with sufficient seriousness to receive the condemnation which they logically deserve.

In re Ambrose Lake Tin and Copper Mining Co., L. R., 14 Ch. D., 390.

Parsons *vs.* Hayes, 14 Abb. N. C., 419.

Flagler Engraving Machine Co. *vs.* Flagler, 19 Fed. Rep., 468.
Foster *vs.* Seymour, 23 Fed. Rep., 65.
Tompkins *vs.* Sperry Jones & Co., 96 Md., 560.
Hutchinson *vs.* Simpson, 92 App. Div., 382.

The case first cited arose in the course of the winding up of the company to which it owes its title, out of a controversy between the official liquidator and two individuals named Moss and Taylor. It appeared that these individuals, with some others, were the owners of a mine of the value of about £6,000, which they assigned to a trustee who was under their control. They then organized the Ambrose Lake Tin and Copper Mining Company, designating as directors in the articles of association themselves and two of their associates in the ownership of the mine. These directors proceeded to buy the mine from the trustee for £24,000 in shares of the new company. Of these shares more than £22,000 were turned over by the trustee to Moss and Taylor, and they sold some of them to the public. The object of the transaction was deemed by the Court to be to give the public an exaggerated idea of the value of the property and to induce the purchase of shares at an excessive price. The company was not successful, and at the end of about six years it was wound up by an order of Court.

The official liquidator obtained from the Vice-Warden of the Stannaries Court, who had charge of the winding-up, an order requiring Moss and Taylor to pay up the difference between the value of their shares in the new company, including the profit on those which had been sold, and the value of their interests in the mine. This

amounted to about £17,000. The Court of Appeal in reversing the order, hold that there was no liability.

JAMES, *J.*, said (p. 395):

"In my view the company only gave back in substance that which it was getting, and the fraud was not between the vendors and the company, the purchasers, but was a thing calculated to delude people into believing that the shares, when got, were something more valuable than they really were. What the company lost, if they lost anything, was this: If they had formed the company and issued shares they might have got the fictitious value which the shares would have brought in the market by availing themselves of the lies respecting the property which they say are contained in the contract. That does not seem to me to be a sort of thing which the company would be entitled to claim."

BRETT, *J.*, said (p. 397):

"However improper or disreputable, as my Lord says, this transaction was, it did no mischief to anybody whom the liquidator represents, and it could only do mischief to people who may have been deceived, but we cannot tell now whether anybody has been deceived. Those persons are not before the Court. Therefore the remedy sought here is by the wrong persons and in the wrong form."

COTTON, *J.*, said (p. 399):

"It may be that what was done was done for the purpose of enabling the company to be passed off on the market as something different from what it was. Whether that was so or not is, in my opinion, immaterial to the present question. But if it was so, the remedy is not an action by the company against those who were vendors and purchasers. The remedy is a remedy of each purchaser of shares, if there were any such, who was deceived by the representations made by his vendor as to the constitution of the company.

In my opinion, not only can this order not be maintained, but even if there has been any profit made by the appellants, we are not in a position at the suit and instance of the company in any way to make them account for it."

Parsons vs. *Hayes*, 14 Abb. N. C., 419, was a decision of the General Term of the Superior Court of New York

City upon a demurrer. The plaintiff brought suit as a stockholder of the Vanhuff Mining, Smelting and Milling Company, on behalf of himself and all other stockholders, against the corporation and one Joseph Hayes and others to compel them to account to the corporation for profits fraudulently made through the sale to the corporation, in exchange for $2,000,000 of stock, of property not worth more than $150,000. Plaintiff alleged that he had purchased his stock regularly in the open market, relying upon the representation that it was full paid. He also alleged that the individual defendants had received large gains and profits from the sale of the portion of the stock that was turned over to them. By a separate defense, which was demurred to, it was alleged that plaintiff derived title to his stock from one Catlow, who received it from the company in part payment for property in the course of the transaction referred to in the complaint. The complaint showed that the entire capital stock had been issued to Catlow in payment for said property.

SEDGWICK, *Ch. J.*, thought judgment should be given for defendants on two grounds: first, because the plaintiff had no greater right than his predecessor, Catlow, had to complain of the transaction in which the latter took part second, because the corporation itself would have no cause of action or right to damages. INGRAHAM, *J.*, concurred only on the first of these grounds; while TRUAX, *J.*, dissented. The learned Chief Judge closed his opinion by saying (p. 434):

> "This opinion has had in regard solely the right of a member of a corporation to require that corporation to assert for his benefit a claim for damages in which he may share, when in reality he stands in the shoes of one who took part in the transaction complained of. His want of

right to maintain such an action does not affect any claim he may have for individual damage from misrepresentation by the corporation or third parties, nor does it affect the claim of creditors or the liability of the corporation or its trustees to an action by the attorney-general."

Flagler Engraving Machine Co. v. *Flagler*, 19 Fed. Rep., 468, was a suit brought by a corporation of Connecticut against certain of its directors and stockholders to recover profits realized in the sale of certain stock. The bill charged that the defendants organized the complainant corporation and caused all of its stock, amounting to $300,000 to be issued for patent rights and then turned back into the treasury of the company $25,000 of the stock so issued. The defendants, acting for the company, employed a broker to sell the treasury stock and published advertisements in which the value of the patent was set forth in the most glowing terms. Some positively false and fraudulent statements were made in these advertisements. The shares were offered in Boston and were quickly taken up at prices ranging from $100 to $300 per share, and even more. The demand being so active, the defendants, as directors of the company, passed a vote, while the sales of treasury stock were still going on, to sell 300 shares more. These shares were contributed by the defendants, *pro rata*, and the proceeds were divided among them in the same manner. The money passed through the hands of the treasurer of the company. Certain foreign patents were assigned to the company in consideration of the permission given to defendants to sell some of their own shares in the manner described. The persons who bought stock at high prices afterwards came into control of the company.

Judge LOWELL held that the corporation was not

aggrieved by the facts shown and that those who inspired the suit had mistaken their remedy. At page 470 he said:

> "From this statement of facts it appears that certain persons were probably induced to buy stock by false and fraudulent representations; and for this wrong I do not doubt that there is a remedy. But I cannot see how the company itself can work out the remedy. * * *
>
> The actual fraud was not in fixing the capital stock at a certain sum, but in puffing the property afterwards; and the persons who suffered were those who were induced to buy shares in the market. The shares were not subscribed for at par, but bought. The purchasers, some or all of them, may have a right to set aside the sales, and to recover their money of the company or the defendants, or both, but they are necessary parties to the suit or suits, and they cannot, by obtaining control of the company, set up an artificial case and recover through the company what is really their own loss, from which the company itself was enriched."

Foster vs. *Seymour*, 23 Fed. Rep., 65, was a suit brought by a stockholder of the Central Arizona Mining Company, on behalf of himself and all other stockholders, to compel the trustees of the corporation to account to it for a fraudulent disposition of capital stock. The bill alleged that the entire capital stock, amounting to $10,000,000, was exchanged by the trustees for mining property owned by themselves, the value of which did not exceed $100,000, as the trustees knew. The bill further alleged that the trustees, after such exchange of capital stock, divided and distributed it among themselves and sold it as full-paid stock to innocent purchasers, including the complainant; that the trustees realized large sums of money thereby, which they applied to their own use. Upon this state of facts Judge WALLACE sustained a demurrer to the bill, saying (p. 67):

> "If the original transaction, in connection with the special facts

of a purchase of stock, should operate as a fraud upon a purchaser, the cause of action would be his, and not that of the corporation. The fraudulent character of the transaction was imparted to it by the corporation itself; that is, by those who represented all there was of the corporation. The remedy of the complainant, if he has been deceived into the purchase of stock by false representations as to its value, is against those who have misled him. Even if he could recover against the corporation or against the trustees (see *Fosdick* vs. *Sturges*, 1 Biss., 255), the corporation has no cause of action against the trustees."

Tompkins vs. *Sperry, Jones & Co.*, 96 Md., 560, was a suit brought by the Receivers of the Maryland Brewing Company, of Baltimore City, to compel the defendants to account for the proceeds of certain bonds of the company alleged to have been unlawfully obtained. The bill was dismissed upon demurrer. It alleged that the defendants obtained options or contracts for the transfer of several of the brewing establishments of Baltimore to a corporation to be organized, and which should issue its bonds and stocks in payment therefor; that by the terms of said contracts the aggregate capitalization of the proposed company was limited to $20 of capital for each barrel of output during the preceding year of the various breweries included in the consolidation; that out of the proceeds of bonds and stock a certain working capital was to be provided, and the remainder, after delivery of the amounts called for by contracts to be delivered to the owners of the breweries, was to go to the defendants as compensation for their services and expenses. The bill further alleged that the defendants compelled the Maryland Brewing Company to assume the obligations of said contracts, and that said breweries were in fact transferred to the company, and that bonds were issued to the amount of $7,500,000, when by the terms of the contracts the bonded

indebtedness should have been limited to $5,820,000; that the issue of bonds and stock was authorized by the stockholders by the acceptance of an offer of Sperry, Jones & Co. to transfer the breweries and furnish the cash working capital in consideration of certain amounts of bonds and stock larger than were warranted by the contracts; that at the time of the acceptance of said offer Sperry, Jones & Co. were the real owners of all the corporation's stock, the same standing in the names of their employees as agents; that the surplus of bonds was in part retained by Sperry, Jones & Co., and in part turned over to certain Trust Companies, who were joined as co-defendants, and it was charged that these Trust Companies had realized a profit by the resale of the bonds.

As to the rights of the corporation as representing the brewers who put their property into the consolidation, the Court said:

> "The relations of Sperry and Jones to each of the brewers were, it is alleged in the bill, fixed by a separate contract. Assuming that these contracts called for the delivery by them to the respective brewers of bonds and stock of the company capitalized on a certain basis and that they delivered securities issued upon a different basis of capitalization, that might afford to each individual brewer a right of action against Sperry & Jones for such damage as he suffered under the terms of his particular contract, but these various contract rights of the different brewers cannot be asserted collectively in this suit by the receiver."

As to the rights of those who may have purchased bonds or stock from Sperry, Jones & Company the Court said (p. 583):

> "When Sperry & Jones offered any of the bonds or stock issued to them by the company for barter or sale to other persons and thus, as it were, invited them to become interested in the enterprise, they were bound, as we have already said, to practice no concealments

toward those persons and to give them all desired information as to their own relation to the company; but this, like their duty to the contracting brewers, was an obligation to each person with whom they so dealt and the rights of their several vendees in case of a breach of the obligation are several and according to the nature of the particular transaction and cannot be collectively asserted in this suit."

Hutchinson v. *Simpson*, 92 App. Div. (N. Y.), 382, was an action by certain stockholders of the American Malting Company, on behalf of themselves and all others, to require the members of the firm of Moore & Schley to account to said company for secret profits alleged to have been realized by them as promoters of the company. The complaint alleged that the defendants obtained options on about twenty-five malting plants situated throughout the United States with a view to the transfer of said plants to a proposed corporation; that the defendants also invited the public to subscribe to the stock of the proposed corporation, and that $9,000,000 of preferred stock and $4,500,000 of common stock were subscribed for by means of letters addressed to Moore & Schley, to be paid for in cash to the amount of $9,000,000; and $3,000,000 of preferred stock and $1,500,000 of common stock was also subscribed to be paid for in malting plants; that all these subscriptions were upon the condition and agreement that all of the stock issued by the proposed corporation would be used by Moore & Schley for acquiring the malting plants upon which they held options, and for working capital and for no other purposes; that the defendants caused the American Malting Company to be incorporated and were in absolute control of its board of directors; that said board of directors entered into a contract with an employee of Moore & Schley to issue pre-

ferred stock to the amount of $12,500,000 and common stock to the amount of $13,740,000 in payment for the malting plants and $2,070,000 of working capital; that the $9,000,000 of cash was actually paid in by the subscribers and was sufficient to pay all expenses of acquiring the malting plants (other than those delivered in payment of subscriptions) and furnishing the working capital; that 5,000 shares of preferred stock and 77,400 shares of common stock remained which were not delivered to the subscribers and were not needed for the purpose of acquiring plants or providing working capital; that said shares should have been returned to the treasury of the American Malting Company, but were instead appropriated by Moore & Schley.

A demurrer to the complaint was sustained.

INGRAHAM, *J.*, said (pp. 399, 400):

"If the purchasers of the stock of the defendant company had suffered damage by reason of a breach of a trust obligation which existed as between them and the individual defendants, that they would have a cause of action against the individual defendants cannot be doubted, but that is not this case. The plaintiffs were not subscribers to the stock of the corporation, but purchased it long after it had been issued for property purchased by the corporation. It does not even appear that the stock that they held was a portion of the stock sold by Moore and Schley under the agreement before mentioned. Nor is the cause of action based on a relation of trust between the plaintiffs and the individual defendants. It is the right of the corporation that is sought to be enforced, and the plaintiffs must establish that there was such a relation between the corporation and the individual defendants, and that the defendants violated their duty to the corporation to entitle the plaintiffs to succeed in this action. No subscriber to this stock has complained of any deception or violation of confidence. The corporation got what it bargained for. All connected with it knew of all the facts alleged in the complaint, and neither the corporation nor the subscribers have sought to rescind the transaction."

VAN BRUNT, *P. J.*, took substantially the same view, and PATTERSON, *J.*, said (p. 407):

> "My view is that the corporation which was organized had no right of action against Moore & Schley and that hence these plaintiffs, as stockholders, derive no right of action from that company. If a wrong has been done it is one to be remedied in favor of those who signed Exhibit A, or those claiming directly under them, and there is no complaint emanating from them."

HATCH, *J.*, who dissented, fully recognized in his opinion the principle upon which we now cite the case as authority. He said (p. 420):

> "If fraud be perpetrated in the sale of stock, the action is in deceit, and lies in favor of the individual wronged against the person doing wrong."

IX.

The bill is not sustainable on the ground that B. D. Harris was a promoter, and bound as such to account for profits.

It is conceded that Mr. Harris was not, technically, a promoter. It is not possible to characterize as a promoter a man who buys stock in a company after it has been in existence for twenty-seven years, and who afterwards makes a bargain with the company for the sale of his own private property at a fair price to persons designated by the company, in order to help the company obtain a loan.

But it is claimed that B. D. Harris was subject to obligations analogous to those of a promoter, because he stood in the same relation to future transferees of the rights of the existing stockholders which a promoter occupies towards those who may be induced to subscribe to

the shares of a corporation through his efforts. In the petition for the writ of certiorari the learned counsel for the petitioner inquires (p. 30):

> "Is there any difference between the duties of a promoter and a director except in degree? Which owe the higher duty to the company? Were not these directors promoters of this loan for the company? Could they secretly issue and sell it stock at a profit to themselves without disclosure?"

We are quite willing to concede that there is no difference, not even in degree, between the fiduciary obligations of a promoter of a corporation in the formative stage and those of a director of a company which is fully organized. There is, however, a vast difference between the companies with which they respectively have to do, in respect to legal capacity for making contracts. The difference between the two cases relates not to the position of the trustee, but to that of the *cestui qui trust.*

The distinction is like that between a trustee for adults and a trustee for unborn infants. Both are trustees; and their rights, powers and obligations in that capacity are similar. But in respect to the possibility of contracting with their *cestuis que trustent*, their situations are altogether dissimilar. A trustee for adults may contract with his beneficiary regarding the trust estate if the latter acts intelligently and independently upon a full and fair disclosure of all the facts.

Narcissa's Ex'r *vs.* Wathan, 2 B. Mon., 241.

Pugh's Heirs *vs.* Bell's Heirs, 1 J. J. Marsh, 399.

Spencer's Appeal, 80 Pa. St., 317.

In re Ledrich, 68 Hun, 396.

Graves *vs.* Waterman, 63 N. Y., 657.

Mills *vs.* Mills, 63 Fed. Rep., 511.

A trustee for infants, of course, cannot do this. The infant may disaffirm the contract, even though such disaffirmance amounts to a fraud on the trustee.

McGreal *vs.* Taylor, 167 U. S., 688.
Tucker *vs.* Moreland, 10 Pet., 58.

The special rules of law regarding promoters turn on the principle that while a corporation is in the formative stage, and is inviting the public to subscribe to its stock, those who have caused it to be formed and are in control of its corporate organization cannot contract with it for any private benefit or advantage to themselves in such a manner as to bind future subscribers to the shares without knowledge of all the facts. The rule excludes not only unfair, exorbitant and dishonest contracts, but also those which are fair and reasonable. Any profit or remuneration whatever to the promoter for his services in enabling the corporation to acquire the property necessary for its business, however just or moderate, is voidable by the corporation, if contracted for at this stage of its existence, unless assented to by every subsequent original subscriber to the shares, with full knowledge of all the circumstances.

Yeiser *vs.* United States Board & Paper Co., 107 Fed. Rep., 340.
Hayward *vs.* Leeson, 176 Mass., 310.

The test of liability is not whether the transaction was beneficial to the corporation or the reverse. The only questions are whether the promoter realized a profit, and whether the subsequent original subscribers to shares knew of it and assented to it. In *Yeiser* vs. *U. S. Board &*

Paper Co. (*supra*), the learned Circuit Court of Appeals for the Sixth Circuit said (p. 348):

> "It is said that the property was worth what the company paid for it, and is adapted to the company's requirements. It happens so. But this in no manner affects the operation of the rule."

From this hasty summary of the law in regard to promoters, it may be seen what would be involved in the adoption of the rule proposed by the petitioner, that the relation between a director and future transferees of the outstanding stock is the same as between a promoter and future original subscribers to the unissued stock. It would mean in substance that every transaction between a corporation and one or more of its directors involving any individual profit to the latter would be voidable at the instance of the corporation unless assented to by every future transferee of its stock. Such a rule would not be an extension of the law relating to promoters. It would be a caricature of it.

The "promoter cases" relied upon by the petitioner all turn on the principle that the corporation, while its membership is still incomplete and the public are being invited to pay money into its treasury upon stock subscription, is in a condition of tutelage with limited capacity to contract.

In Lord MacNaghten's opinion in *Gluckstein* vs. *Barnes* (1900) A. C., 248, he thus describes the corporation, in this inchoate condition of its powers:

> "They appoint themselves sole guardians and protectors of this creature of theirs, half-fledged and just struggling into life, bound hand and foot while yet unborn, by contracts tending to their private advantage, and so fashioned by its makers that it could only act by their hands and only see through their eyes."

In *Erlanger* vs. *New Sombrero Phospate Company*, 3 A. C., 1218, Lord CAIRNS said of promoters (p. 1236):

> "They have in their hands the creation and molding of the company; they have the power of defining how and when and in what shape and under what supervision it shall start into existence and begin to act as a trading corporation."

Some of the learned Chancellor's observations in this case are certainly very broad, but it must be remembered that his judgment was to the effect that the transaction complained of had in effect been ratified by the corporation, *after its shares had been fully subscribed*, and on this ground he voted to reverse the order of the Court of Appeal. This excludes the idea that he intended to hold that any further ratification would have been needed if the transaction had taken place *after the shares had been fully subscribed* and the subscribers were in control of the company. Concerning his opinion on this occasion, Lord DAVEY said, in *Salomon* vs. *Salomon & Co.* (1897), A.C.,57:

> "Of course, Lord Cairns' observations were directed only to a case such as he had before him, where it was attempted to bind a large body of shareholders by a contract which purported to have been made between the vendor and directors *before the shares were offered for subscription.*"
>
> (The italics are ours.)

In *Lagunas Nitrate Co.* v. *Lagunas Syndicate* (1899), 2 Ch. 392, one of the most recent and instructive cases on promoters' liability, it was said by LINDLEY, M. R. (p. 428):

> "The Nitrate Company, although in one sense formed when registered, was not completely formed, as contemplated by the promoters, until a prospectus had been issued and a large capital had been subscribed."

London Trust Company, Limited, v. *Mackenzie*, 68 L. T., 380, was not a case of holding promoters liable for

profits, but of holding directors liable for a misapplication of the capital of the company. We shall discuss it, therefore, in connection with the question of directors' liability.

In sharp distinction from the English "promoter cases," of which a great number might be cited, is the case where the organizers of a corporation do not intend to invite the public to become original subscribers, but do intend to acquire all the shares themselves and then to offer their own shares for sale to the public. In that case it is held that each individual sale stands on its own basis of facts, as between vendor and vendee, and the corporation has no concern in it. (*In re Ambrose Lake Tin & Copper Mining Co.*, 14 Ch. D., 390; *In re Innes & Co., Limited* (1903), 2 Ch. D., 254; *Hutchinson* v. *Simpson*, 92 App. Div., 382, 420; *Tompkins* v. *Sperry, Jones & Co.*, 96 Md., 560; *Venner* vs. *Atchison, &c., R. Co.*, 28 Fed. Rep., 581; *Stewart* vs. *St. Louis, &c., R. Co.*, 41 Fed. Rep., 736; *Church* vs. *Citizen's Street R. Co.*, 78 Fed. Rep., 926; *Drake* vs. *N. Y. Suburban Water Co.*, 26 App. Div., 499; *Ban* vs. *Railroad Co.*, 125 N. Y., 263; *Higgins* vs. *Lansingh*, 154 Ill., 301.) Many of these cases are discussed at length under Points (VIII.) and (XIV.).

Hayward v. *Leeson*, 176 Mass., 310, was a case where promoters voted themselves a remuneration for their services before the stock had been subscribed and failed to state that fact in the prospectus. The Court said (p. 319):

> "Payment to promoters of remuneration for their services is not made valid by a vote passed by the corporation when the corporation is in the sole control of the promoters *before the capital has been issued to the public.*"
>
> (The italics are ours.)

And on page 320:

> "The persons to whom the promoters owe the duty which they owe by reason of their fiduciary relation are the persons who put their money into the enterprise at the invitation of the promoters, that is to say, the future stockholders."

The "future stockholders" referred to by the Court are not the transferees of existing stockholders; they are the future holders of the unissued stock which is being offered to the public for subscription. This is evident from the words "persons who put their money into the enterprise at the invitation of the promoters," that is to say, persons who pay money into the treasury of the company. Persons who become transferees of existing, outstanding stock, and who do not pay money into the treasury of the company are not "putting their money into the enterprise." They are buying shares of stock exactly as they would buy any other species of personal property. The money they pay goes to the person whose property they get, and they cannot claim that they have succeeded to the benefit of any fiduciary relation, unless that relation also existed towards the person whose shares they have acquired.

That the Court was using the words "future stockholders" in this sense is evident from what is said in regard to the manner in which promoters may properly obtain remuneration (p. 320):

> "Promoters can make the necessary disclosure of the remuneration they stipulate for by including in the prospectus a full statement thereof; if such a statement is not made therein, they cannot honestly take any remuneration for promoters' services, unless it is voted by the stockholders after the capital stock has been taken by the public."

Here is a plain intimation that assent to the promoter's remuneration by a subscriber to capital stock with knowl-

edge thereof derived from the prospectus, *binds not only the subscriber but all his subsequent transferees.* Otherwise it would be necessary to wait, before actually paying over the agreed remuneration, until it could be ascertained whether or not such subsequent transferees would take with like knowledge; that is, it would be necessary to wait until the liquidation of the corporation and the final distribution of its assets.

It was in regard to the same transaction, condemned in *Hayward* vs. *Leeson*, that the learned Circuit Court of Appeals for the Sixth Circuit, said, in *Central Trust Co.* vs. *East Tennessee Land Co.*, 116 Fed. Rep., 743, 747:

> "This wrong was part of similar transactions which *debilitated the corporation in its infancy* and, we have no doubt, contributed largely to its downfall."

The language of Judge WALLACE, in *Cortes Co.* vs. *Thannhauser*, 45 Fed. Rep., 730, in defining the persons toward whom a promoter stands in a fiduciary relation, is almost the same as that above quoted from *Hayward* vs. *Leeson*. The learned Judge said (p. 739):

> "It is the duty of a promoter *towards those who are invited to co-operate in the enterprise* not only to abstain from stating as a fact that which is not so, but not to omit to state any fact within his knowledge the existence of which might in any form affect the extent or the quality of the advantages held out as an inducement."

Clearly, by the words "those who are invited to co-operate in the enterprise" he meant, as the context indicates, those who are invited to become original subscribers to the stock. He did not mean transferees of stock from the promoter himself, for, in his own opinion, in *Curtiss* vs. *Hurd*, 30 Fed. Rep., 729, he said, in relation to such a transaction (p. 734):

> "It is true that, as a general rule, the shareholder of a corporation is

not held to the liabilities of a member of an ordinary partnership for the debts of the concern, and a purchaser of shares does not expect to incur such a liability as a consequence of his purchase. But it cannot be affirmed that a purchaser of shares who buys without inquiry as to the character of the corporation of which he proposes to become a member, or as to the nature of the liability of the stockholders, has any legal right to complain, if he finds, after he has purchased, that the stockholders are liable for all the debts of the concern. No authority for such a proposition has been cited by counsel. If it can be maintained it can only be done by importing an implied warranty against such a liability into every sale of shares in a corporation. No such exception to the rule of *caveat emptor* is known to the law."

In *Brewster* vs. *Hatch*, 122 N. Y., 349, the learned Court said (p. 362):

"These defendants were the promoters of the corporation and occupied, *before its organization*, a position of trust and confidence towards those whom they induced in invest in the enterprise."

In *South Joplin Land Co.* vs. *Case*, 104 Mo., 572, is an exceeding clear and able statement of the law in regard to promoters' liability and its limitations. The learned Court said (p. 579):

"But the persons who thus project and form a corporation by soliciting and procuring others to subscribe for and take shares of stock, for the purpose of selling or turning over to the company property which they own or have a right to acquire by executory contract, do occupy a double position. On the one hand, they represent their own interest in respect to the disposition of the property. On the other they represent the proposed corporation; and persons who subscribe for stock have a right to do so upon the assumption that the promoters are using their knowledge, skill and ability for the benefit of the company."

In *Yeiser* vs. *United States Board & Paper Co.*, 107 Fed., 340, the learned Court briefly summarized the general doctrine regarding promoters' liability, as follows (p. 348):

"In this country the courts have accepted the essential principle laid down in the English cases and hold, with scarcely any variation, to the

doctrine that the promoter of a company stands in the relation of a trustee to it, *and those who become subscribers to its stock*, so long as he retains the power of control over it."

These cases all recognize the essential difference between inducing a man to become a subscriber to an original issue of stock and inducing him to become a purchaser of stock which has already been issued. In the former case there is an implied representation to every subscriber that he is being brought into the company on terms of equality with all other subscribers; in the latter case there is no implied representation that the purchaser is being brought in on the same terms as though he were an original subscriber, nor that he is being brought in on the same terms as all other purchasers. The law does not invite anyone to believe that the consideration paid upon a sale of stock is governed by anything other than the operation of the law of supply and demand, as applied to that particular transaction. If the purchaser desires anything more he must get a warranty. But the law does warrant a man in believing, when he becomes a subscriber to an original issue of stock, that he is being treated exactly as all other subscribers are treated and that none of his associates, through their dealings with the company, are making profits which are not disclosed to him.

From the nature of the case it follows that when the company has issued all the stock which it intends to issue and the subscribers are in control of the company, the promotion is at an end. As to his future dealings with the company the promoter stands on the same basis as any other individual. If he is a director he is subject to the obligations and limitations of the office. If he is a stockholder he has all the powers and rights and liabili-

ties which attach to that status. If he has made profits by any dealings with the company during the period of promotion he remains liable to account for them, but for the future his liberty of action is as complete as though he never had been a promoter.

Lagunas Nitrate Company *vs.* Lagunas Syndicate (1899), 2 Ch. D., 398, 436.

The fact that a certain part of the authorized capital stock remains unissued, when there is no present intention of issuing such shares, does not invalidate a transaction between a promoter and his company which is assented to by all the subscribers to stock actually issued.

In re British Seamless Paper Box Co., 17 Ch. D., 467.

It follows that whether Mr. Harris be regarded as a promoter or not, the fact that all the transactions in which he took part were assented to by the holders of the entire capital stock of the company, at a time when the company had issued all the capital stock which it intended to issue, precludes any assertion of liability on this ground.

If any "promotion" took place it was in 1889, and Mr. Harris could not be called upon to account for profits on the sale of property which he had owned since 1883, even though the form in which the property was represented had been changed.

Densmore Oil Co. *vs.* Densmore, 64 Pa. St., 43.

In re Cape Breton Company, 29 Ch. D., 795.

In re Lady Forrest (Murchison) Gold Mine (1901), 1 Ch. D., 582.

X.

The bill is not sustainable upon the ground that it is brought for the avoidance of a transaction between the corporation and one of its directors, or to compel a director to account for illicit profits.

In order to succeed in this action the complainant must show that there was some liability attaching to defendants' testator by reason of one or both of the increases of stock, or else that such liability attached by reason of the contract authorized by the directors at their meeting on May 3, 1889, in respect to the sale of bonds and stock.

Defendants' testator is not to be condemned because he subsequently performed or accepted performance of a contract which was lawful and binding on the corporation, when made, and which the corporation could have been legally compelled to perform.

At the time when said stock was issued and also at the time when said contract was made, there were in this corporation seven stockholders and seven directors. All the stockholders were directors and all the directors were stockholders. The transactions now complained of were participated in by all the directors and stockholders except James C. Holden, who had only a nominal interest and who never objected.

Under these circumstances it is too clear for argument

that the ordinary rules regarding transactions between corporations and their directors do not apply.

G. V. B. Mining Co. *vs.* First National Bank, 95 Fed. Rep., 23.

McCracken *vs.* Robison, 57 Fed. Rep., 375.

Barr *vs.* Railroad Co., 125 N. Y., 263.

Battelle *vs.* Northwestern Cement, &c., Co., 37 Minn., 89.

Such transactions, if subject to no other objection than that arising from the conflict of interest between the director and the corporation, may always be ratified by a majority of stockholders.

Twin Lick Oil Co. *vs.* Marbury, 91 U. S., 587.

Hotel Co. *vs.* Wade, 97 U. S., 13.

Pneumatic Gas Co. *vs.* Berry, 113 U. S., 322.

U. S. Steel Corporation *vs.* Hodge, 64 N. J. Eq., 807).

The majority of stockholders could elect a new board of independent directors to confirm the contract, and what they might do indirectly they can also do directly.

Interest in the transaction does not disqualify a stockholder to be counted as part of the ratifying majority.

Gamble *vs.* Queens County Water Co., 123 N. Y., 91.

Northwest Transportation Co. *vs.* Beatty, 12 App. Cas., 589.

U. S. Steel Corporation *vs.* Hodge, 64 N. J. Eq., 807.

Worth, &c., Co. *vs.* Bingham, 116 Fed. Rep., 785.

Even where the corporation refuses to ratify the transaction it cannot retain the directors' property at a less price than he has agreed to accept, unless it is property which he acquired as a trustee for the corporation. In such a case rescission is the only remedy.

Burland *vs.* Earle (1902), App. Cas., 83.

Duncomb *vs.* Railroad Co., 84 N. Y., 190.

Wardell *vs.* Union Pacific R. Co., 4 Dill., 330; 103 U. S., 651.

If rescission is not tendered promptly and the situation materially changes the right to rescind is gone.

Twin Lick Oil Company *vs.* Marbury, 91 U. S., 587.

Kessler & Co. *vs.* Ensley Co., 123 Fed. Rep., 567; 129 Fed. Rep., 397.

Rothchild *vs.* Memphis, &c., R. Co., 113 Fed. Rep., 476.

In this case there was no offer to return the stock which B. D. Harris surrendered, and even if such an offer had been made it would have come too late.

The question whether B. D. Harris did his full duty as a director of the Great Western Mining and Manufacturing Company in respect to the making of the contract of May 3, 1889, may be considered in the light of the question, What would have been the course of an independent board of directors, composed of men of integrity and sound judgment, but with no direct interest in the stock, if they had been in office on that date?

We may assume that if they could have gotten any one to make a *gift*, either of money or of stock, to the com-

pany it would have been their duty to accept it. If they could have gotten anyone to buy bonds, unaccompanied by stock, at a price better than 60, it would have been their duty to do it. But, in the absence of either of these opportunities, how could they have acted more wisely than the board that was actually in office? Stock to the amount of $350,000 was outstanding and the earnings were not sufficient to pay dividends on any more. There was a large floating debt and a necessity for improvements. The directors were confronted by the statement that bonds accompanied by a bonus of 50 per cent. in stock could probably be sold at 85 and that bonds without a bonus of stock probably could not be sold at all. There were, in fact, but three courses for the directors to choose from:

(1) To issue more stock. This, in view of the earnings, would have been injudicious and the directors could not do it anyway without the consent of the stockholders. Chicago City Railway Co. *vs.* Allerton, 18 Wall. 233.

(2) To refrain from selling bonds. This would have left the company exposed to the peril of the enforcement of its floating debt—a peril which subsequent events showed to be real and substantial.

(3) To agree with stockholders to sell their stock in connection with bonds, on the basis of a fair division of proceeds.

The latter course is the one which the directors elected to pursue, and they did it in such a way that all stockholders who desired to participate in the transaction were

treated alike. Unless it was wrong for them to sell the bonds of the company at 60, there was no wrong with which they are fairly chargeable.

London Trust Company, Limited, vs. *Mackenzie*, 68 L. T., 380, which is the principal case cited by the petitioner in support of the proposition that B. D. Harris was liable on account of his conduct as a director, is relevant only to that feature of the conduct of defendants' testator, which consisted in distributing the increases of stock equally among the stockholders. It has nothing to do with the disposition made of the stock after it was distributed. In the case cited, the defendants did not appear to have disposed of any of their own shares. The Court referred to false statements in the registered contract and prospectus, but in the end rendered judgment on the same basis against Sir James Mackenzie, who was not a party to these false statements, as against the other defendants. The case is authority only for the principle that shares and debentures may sometimes be issued in such a way as to expose directors to liability. In the case at bar the gravamen of the charge relates to the manner in which the stock was disposed of, not to the manner in which it was issued. The petitioner very frankly said in his petition for the writ of certiorari (p. 21):

> "They could not even have sold the stock which they legitimately owned in this way, much less that which they took in order to use in this illegitimate way."

London Trust Company vs. *Mackenzie* was not a case of a *pro rata* distribution of shares. It was a case of the issue by the directors of the Barbados Water Supply Company, Limited, to the contractors for the com-

pany's works, of debentures and shares in excess of the amount to which they were entitled, upon the understanding that a portion of the excess should be used in compromising a claim of certain brokers against the company which was entirely without foundation, although some of the directors were interested in enforcing it. The remainder of the excess was intended to be distributed unequally among persons interested in the company, in such a way as to secure their acquiescence in the plan. The Court said (p. 383):

> "These arrangements would, in the aggregate, provide a considerable though not uniform bonus to every holder of any previously-existing share or debenture, and would satisfy the brokers' debt and claims, and would be carried into effect out of the £98,000 new debentures added for this express purpose to the real cost of the works and out of the new shares to be issued to the contractors."

Regarding the claim of the brokers, which was compromised, the Court said (p. 384):

> "The directors gave away the company's money to pay in full a debt which did not exist, and there was not any compromise."

It was not true that all persons interested in the company had knowledge of this transaction and approved it. In answer to such a claim the Court said (p. 385):

> "No doubt most of the holders of shares or debentures existing at the time of the agreements had more or less knowledge of the general purpose of the scheme, but it is not proved that all had such knowledge. No circular explaining the matter was issued, nor was any general meeting called, nor does a mere general knowledge of and assent to the principles of the scheme involve knowledge of the benefit which the directors were to take."

The case differs from the case at bar in the following particulars, among others:

(*a*) It was a case of the distribution of debentures as well as of shares.

(*b*) The distribution was unequal.

(*c*) The distribution was not made by unanimous consent.

(*d*) Such consent as was given was not accompanied by knowledge of the directors' secret profit.

(*e*) The purpose of the transaction was to enable the brokers to obtain an unfair advantage over the stockholders who were not directors.

(*f*) The corporation was in a formative state, with its works uncompleted, and it had shares in its treasury which it intended to issue to the public for cash.

(*g*) The corporation had no fund of accumulated earnings to justify a dividend to its stockholders.

(*h*) The form of the action was not such as to require the Court to distinguish between the corporation's right to damages at law for misfeasance, and the directors' liability to account in equity for illegitimate profits.

(*i*) The defendants were held liable for the value of the debentures improperly distributed; but in respect to the shares the only judgment was a *declaration* that the company had a right to indemnity against the defendants for any loss that the company might sustain by reason of the shares having been allotted as full paid without consideration. In the case at bar it is clear that the Mining Company has sustained no loss by reason of the increase of stock in 1888 and 1889, because nothing is distributable to any of the stockholders and it makes no difference to anyone whether the shares issued pursuant to those increases are deemed outstanding or cancelled. A company cannot have indemnity against loss when there is no possibility of loss.

Christensen *vs.* Eno, 106 N. Y., 97, 102.

XI.

The bill is not sustainable upon the ground that it was *ultra vires* of the corporation to deal in its own stock.

The only doubt which the parties to this transaction had in 1889 about its legality arose from the question whether, if it took the form of a sale of stock to the corporation, such stock would not be cancelled, in legal effect, as soon as the corporation acquired it (Rec. 274). This question was determined in the negative, two years later, by the decision of the Court of Appeals of Kentucky in

Jefferson *vs.* Burford, 13 Ky. L. Rep., 650; 17 S. W. Rep., 855.

In the petition of the receiver for leave to bring this suit (Rec., 365) and also in the bill (Rec., 5) the gist of the offense charged against defendant's testator is *the sale to the corporation of its own stock* as a device for abstracting money from its treasury. The "proposition" presented to the directors at their meeting of May 3, 1889, expressly declared that the transaction should not constitute a sale of stock to the corporation, but should be deemed a sale direct to the individual purchasers (Rec., 352). The receiver, observing the earnestness and impressiveness of this declaration, naturally supposed that he had only to contradict it in order to state a perfectly good cause of action.

The theory of the petition and bill, therefore, is that the transaction complained of, while in form a sale of

stock to the individual purchasers, was in substance a sale to the corporation.

We venture to believe, on the contrary, that if the transaction had been in form a sale to the corporation, this Court would easily be able to see that it was in substance a sale to the individual purchasers of stock. The substance of a transaction is determined by the ultimate result aimed at; not by conditions arising incidentally and temporarily on the way to its accomplishment.

No doubt a purchase by a corporation of its own shares, *prima facie*, is *ultra vires*; and such a transaction may be made a cover for gross wrongs against existing creditors and against non-participating stockholders.

Hall *vs.* Henderson, 126 Ala., 449; 61 L. R. A., 621.

Hope *vs.* International Financial Society, 4 Ch. D., 327.

Trevor *vs.* Whitworth, 12 App. Cas., 409.

Marvin *vs.* Anderson, 111 Wis., 387.

This general rule, however, is subject to numerous exceptions and among others, to these:

(*a*) A corporation may buy its own shares for the purpose of resale, if the transaction is in aid of the exercise of some other corporate power. The test is whether the loss, if any, sustained upon the resale can be deemed an expenditure for a legitimate corporate purpose.

Johnson County *vs.* Thayer, 94 U. S., 631.

New England Trust Co. *vs.* Abbott, 162 Mass., 148; 27 L. R. A., 271.

City Bank *vs.* Bruce, 17 N. Y., 507.

Fremont Carriage Mf'g. Co. *vs.* Thomsen, 65 Neb., 370.

State *ex rel.*, Page *vs.* Smith, 48 Vt., 266.

In re Dronfield Silkstone Coal Co., 17 Ch. D., 76.

In re Balgooley Distillery Co., Ir. L. R. 17 Eq., 239.

(*b*) A corporation may employ its surplus profits, declarable as dividends, in the purchase *pro rata* of its full paid shares for the purpose of retirement. Such distribution of profits among stockholders does not amount to an impairment of capital, and the diminution of the number of shares outstanding is not harmful to any one, so long as the capital is not impaired.

Leland *vs.* Hayden, 102 Mass., 542.

Howe Grain, &c., Co. *vs.* Jones (Tex.), 51 S. W., 24.

State *vs.* Minnesota Thresher Mfg. Co., 40 Minn., 213.

Hamor *vs.* Taylor-Rice Engineering Co., 84 Fed. Rep., 392.

In re Denver Hotel Co., 62 L. J. Ch. (N. S.), 450.

On July 1, 1889, The Great Western Mining & Manufacturing Company had surplus earnings amounting to at least $61,789.37, which in the absence of any stock dividend could lawfully have been declared as cash dividends (Rec., 209 to 212, 295; *supra*, p. 7). The fact that these earnings were drawn from the corpus of the

property did not prevent their distribution to stockholders, in view of the nature of the enterprise.

People *vs.* Roberts, 156 N. Y., 585.

Lee *vs.* Neuchatel Asphalte Co., 41 Ch. D., 1.

Nor was their distribution as dividends forbidden because they had been invested in permanent improvements.

Mills *vs.* Northern R. Co., L. R., 5 Ch., 621.

In re Mercantile Trading Co., L. R. 4 Ch., 475.

So long as the principle of equality between stockholders was observed, no one would have been injured if the distribution had taken the form of a *pro rata* purchase of stock for retirement. If it had been intended to distribute the surplus profits, such a mode of doing it would have been particularly appropriate, where the stock purchased was stock which had been issued as a stock dividend.

But it was not desired to distribute these surplus profits, and the substance of what was intended to be accomplished was not a purchase of stock by the corporation, but a sale of mortgage bonds so as to obtain more money for corporate purposes. To aid in that exercise of corporate power, the company facilitated the transfer of stock from one set of individuals to another, without being under the necessity of employing its own funds in buying the stock and reselling it.

But, we contend, if such a necessity had existed, the corporation would have been justified in employing its funds in that manner. This would have been so even if the resale involved a loss. Here, there was no loss, as the

courts below have affirmatively found, because bonds which could not be sold at sixty, without stock, were floated at that price by the means employed. The corporation was enabled to borrow money on more favorable terms than were otherwise obtainable.

The question whether a transaction is *ultra vires* or not must be judged from its general scope and purpose, not by a critical scrutiny of its details. (*Central Ohio Natural Gas Co.* vs. *Capital City Dairy Co.*, 60 Ohio St., 96; 64 L. R. A., 395.) If the corporation found that it could not sell its bonds without having them printed from engraved plates, it might contract for the preparation of such plates, although not ordinarily authorized to engage in the business of engraving. So, if a circular were needed for the same purpose, the company might lawfully contract for its preparation, printing and distribution, although the business of publishing was not among the purposes named in its charter. And then, if the bonds still could not be sold unless accompanied by railroad tickets, theatre tickets or trading stamps, it would not be an *ultra vires* act to employ the corporate funds in buying such articles, to the extent that they were needed in order to dispose of the bonds.

Would not the same thing be true if it were necessary, in order to sell the bonds, that they should be accompanied by stock of a railroad company or a navigation company? Even though the corporation were without power to buy such stocks for the purpose of investment or control, it would not be prohibited from acquiring and transfering them in aid of some other legitimate exercise of corporate power.

Precisely the same line of reasoning applies when a corporation purchases its own stock. If it is done for the mere purpose of speculation or to sustain the price of the stock in the market or as a means of enabling one or more stockholders to obtain possession of corporate assets, it is clearly *ultra vires*. If it is done for the purpose of resale, so as to aid in effecting a loan, it is legitimate. Neither the corporation nor the stockholder is bound to play into the hands of a middleman. If an advantage is to be had by offering stock and bonds in conjunction, they are not bound to leave that advantage to an individual who is shrewd enough to buy them up and combine them.

In *Johnson County* vs. *Thayer*, 94 U. S., 631, it appeared that a railroad company agreed with a county to complete its road at an earlier date than had been originally agreed upon, in consideration of the surrender by the county of its interest in the railroad company's stock. This court held that it was not *ultra vires* for the company to incur the additional expense involved in constructing its road quickly, and that the surrender of stock to induce it to accelerate the construction was not unlawful.

In *New England Trust Co.* vs. *Abbott*, 162 Mass., 148, the company sued to enforce the provisions of an agreement whereby, upon the death of a stockholder, it was entitled to acquire his shares at an appraised valuation for the purpose of disposing of the same to persons who, from their situation and character, appeared likely to promote confidence in the stability of the institution. It was held that the agreement was not *ultra vires* and would be en-

forced. This is a border-line case, but it is supported by the decision of the Court of Appeal in the matter of *Dronfield-Silkstone Coal Company*, 17 Ch. D., 76, where in order to procure the retirement of a director and promote harmony in the management of the company, the corporation purchased his shares.

In *City Bank* vs. *Bruce*, 17 N. Y., 507, it was held that a corporation could lawfully purchase its own shares with the intention of reselling them, for the purpose of avoiding loss upon a debt. The case has been extensively followed, and rightly so, for the loss, if any, sustained upon a resale of the shares is merely part of the expense of collecting the debt.

In *Dupee* vs. *Boston Water Power Co.*, 114 Mass., 37, a water company offered for sale certain tracts of land for which it had no further use, agreeing to receive shares of its capital stock in payment therefor. The court declined to interfere, deeming the loss, if any, upon a resale of the stock to be merely a part of the expense of marketing the land. This is like the case of *Balgooley Distillery Co.*, Ir. L. R. 17 Eq., 239, where a company had accumulated a large stock of whiskey which it was unable to sell, and it sold a quantity to its stockholders taking payment partly in cash and partly in shares of stock.

In *Fremont Carriage Mf'g Co.* vs. *Thomsen*, 65 Neb., 370, the Court sustained a contract whereby a corporation, for the purpose of obtaining the services of of an employee, sold him stock and agreed to take it back if he was discharged. The loss, if any, sustained upon a resale was merely a part of the expense of procuring the employee's services.

In *Price* vs. *Pine Mountain Iron & Coal Co.*, 17 Ky. L. Rep., 865; 32 S. W., 267, it appeared that a corporation which was desirous of disposing of all its property received offers therefor from two individuals. One of them claimed to have an option, but the other made the better offer. For the purpose of being enabled to accept the latter offer without litigation the corporation agreed with the first bidder to sell him 2,500 shares of its stock at $25 a share. News of the proposed liquidation leaked out and the price of the stock advanced rapidly. The corporation was able to buy only 418 shares in the market. In order to fulfill its contract it purchased the remainder from certain directors who received therefor the corporation's notes at $50 per share, which was less than the shares would have been entitled to receive according to the terms of the proposed liquidation. The transaction fell through and the stock was not resold. The Court of Appeals of Kentucky held that the notes could not be enforced and that the purchase of the stock from the directors was voidable at the option of the corporation. The Court held, in substance, that the purchase of shares for resale was justifiable only in aid of the power and purpose of the corporation to sell all its assets; that the purchase was therefore contingent and dependant upon the making of such a sale. The Court said:

> "Corporations ought not to be allowed to speculate in their own stocks; and while they may not always do an illegal thing in buying in their own stock, such a transaction must be not only in entire good faith, but the exchange must be of equal value, and the transaction free from all fraud, actual or constructive, and when the corporation is neither insolvent nor in process of dissolution; and, further, the rights of creditors are not to be injuriously affected. * * * We may add

to these qualifications that the contract of exchange ought not to be to the advantage of a few favored stockholders, to the injury of the great body of them."

There is very little difference in principle between a corporation's purchase of its own stock and its purchase of stock in another company where the latter form of investment is not permitted by its charter. It has been held repeatedly that a corporation, without express authority in its charter, may acquire shares of stock in another corporation if it is done temporarily in aid of some other legitimate corporate object.

Hodges *vs.* New England Screw Co., 3 R. I., 9.

Howe *vs.* Boston Carpet Co., 16 Gray, 493.

Treadwell *vs.* Manufacturing Co., 7 Gray, 393.

County Court *vs.* B. & O. R. Co., 35 Fed. Rep., 161.

M'Cutcheon *vs.* Merz Capsule Co., 71 Fed. Rep., 787, 792.

Metcalf *vs.* American School Furn. Co., 122 Fed. Rep., 115.

Talmage *vs.* Pell, 7 N. Y., 328.

In this case if any stock was purchased by the corporation it was for the purpose of immediate resale, without loss, and only to the extent that such purchase and resale of stock were actually necessary in order to float its bonds.

Even if the transaction was *ultra vires*, that would give the corporation no right to recover the money paid after the contract had been fully executed on both sides.

Louisville Tobacco Warehouse *vs.* Stewart (Ky.), 70 S. W. Rep., 285.

Thomas *vs.* West Jersey R. Co., 101 U. S., 71.

St. Louis, &c., R. Co. *vs.* Terre Haute, &c., R. Co., 145 U. S., 393.

Central Transp. Co. *vs.* Pullman Palace Car Co., 139 U. S., 56.

Holmes, &c., Mfg. Co. *vs.* Holmes, &c., Metal Co., 127 N. Y., 252.

Metcalf *vs.* American School Furn. Co., 122 Fed., 115.

XII.

The claim for repayment of dividends is not supported by allegations or proof.

The only charge in the bill is that B. D. Harris negligently permitted John Carlisle to pay dividends to persons unknown, such dividends not being earned (Rec., 6). Such a cause of action was not within the jurisdiction of the Circuit Court, sitting in equity (*supra*, Point I [c]), nor would it survive the death of B. D. Harris (*supra*, Point I [b]). There was no allegation that B. D. Harris received any dividends after 1889.

The uncontradicted evidence is that no dividends were paid to B. D. Harris after January 1, 1891 (Rec., 117). After that date Mr. Harris left his dividends with the company as a loan (Rec., 149). The business of the company at that time was profitable. The earnings in 1891 were over $30,000 (Rec., 148). There is no proof of any definite payments of dividends to Mr. Harris or of any definite lack of earnings in any particular year.

There is no allegation in the bill, and there is no proof

that Mr. Harris received payment of any dividends, knowing that they were not warranted by earnings. Such knowledge must be alleged and proved in order to subject a stockholder to liability to repay dividends received.

McDonald *vs.* Williams, 174 U. S., 397.

New Hampshire Savings Bank *vs.* Richie, 121 Fed. Rep., 956.

XIII.

The bill is not sustainable on the ground of liability on stock not full paid.

(*a*) No such claim is within the scope of the order authorizing the suit to be brought (Rec., 366).

(*b*) There is no allegation in the bill that B. D. Harris owned any stock not full paid at the time when the Receiver was appointed or at the time when the bill was filed (Rec., 3).

(*c*) If there were any cause of action on this ground, it would have to be asserted by creditors and not by the corporation (*supra*, Point I. [a]).

(*d*) The evidence shows affirmatively that all the stock issued to B. D. Harris in 1888 and 1889 was transferred by him prior to April 1, 1890 (Rec., 221–223).

(*e*) The claim of liability on this ground is virtually abandoned by the petitioner at page 17 of the petition for the writ of certiorari.

XIV.

The corporation and all its stockholders are estopped from questioning the transactions now complained of.

By invoking the principle of estoppel we do not mean to concede that anything was done by B. D. Harris, in the course of the transactions herein discussed, of which the corporation or any of its stockholders could justly complain, even if not estopped. On the contrary, we have endeavored to show by the foregoing argument that there is no basis whatever for the charges of wrongdoing and breach of trust brought against Mr. Harris by the bill of complaint.

Assuming, however, for the sake of argument, that the facts alleged and proved make out a case, according to the words of the bill, of "depleting the assets" or "abstracting money from the treasury of the company," still we assert that the Receiver cannot complain of the transaction, because the corporation and everyone interested in the corporation is estopped or otherwise debarred from making such a complaint.

(*a*) Prior creditors were all paid (Rec., 140).

(*b*) Subsequent creditors cannot and do not object.

(*c*) All stockholders at the time consented.

(*d*) The present stockholders are bound by the assent of their predecessors in title.

That the present stockholders are precluded from objecting, results almost of necessity from the ruling of this Court in *Graham* vs. *Railroad Co.*, 102 U. S., 148. In

that case it was held that where a corporation, solvent at the time and having no actual intent to defraud creditors, disposes of its property for an inadequate consideration or by a voluntary conveyance, with the assent of all its stockholders, its subsequent creditors cannot question the transaction. The decision in the case cited was based to some extent upon the local law of Wisconsin, where the lands in question were located, but the principle of the decision has since been adopted and relied on as a rule of general application.

McDonald *vs.* Williams, 174 U. S., 397.

Porter *vs.* Pittsburgh, etc., Steel Co., 120 U.S., 649, 673.

Laut *vs.* Manley, 71 Fed. Rep., 7, 18.

Boston, &c., Trust Co. *vs.* Merchants' Telegraph Co., 36 Fed. Rep., 288, 297.

Toledo, &c., R. Co. *vs.* Continental Trust Co., 95 Fed. Rep., 497, 519.

Ready *vs.* Smith, 170 Mo., 163, 175.

Hamilton *vs.* Quarry Co., 106 Wis., 352, 360.

Rollins *vs.* Shaver Wagon, &c., Co., 80 Ia., 380, 390.

Morgan *vs.* Brower, 77 Ga., 627, 635.

It seems too clear for argument that if subsequent creditors have no right to impeach such a transaction, the successors in interest of the assenting stockholders cannot be permitted to use the corporate machinery to accumulate and distribute a fund in which creditors would have no right to share (*Drake* vs. *N. Y. Suburban Water Co.*, 26 App. Div., 499, 514). The decision in *Graham* vs. *Railroad Co.* goes upon the ground that a corporation, by assent or acquiescence, can lose the right to object to

a transaction prejudicial to its interest as effectively as an individual. If the right is so effectively lost that a creditor cannot reach it, it is difficult to imagine upon what theory a subsequent purchaser of stock can claim an interest in it.

The precise question as to the right of a transferee of an assenting stockholder to question corporate proceedings had before he acquired his stock, has seldom arisen in the Federal Courts, because persons who were not stockholders at the time of the transactions complained of seldom become complainants in these courts. There are, however, a number of cases requiring consideration in this connection, in which the status of such a stockholder has been directly or indirectly involved.

Railroad Co. *vs.* Howard, 7 Wall., 392, 415.

DaPonte *vs.* Louisiana State Lottery Co., Fed. Cas., 3,569.

Langdon *vs.* Fogg, 18 Fed. Rep., 5.

Leo *vs.* Union Pacific R. Co., 19 Fed. Rep., 283, 285.

Venner *vs.* Atchison, &c., R. Co., 28 Fed. Rep., 581, 591.

Stewart *vs.* St. L., &c., R. Co., 41 Fed. Rep., 736.

Wood *vs.* Corry, &c., Co., 44 Fed. Rep., 146.

Brown *vs.* Duluth, &c., R. Co., 53 Fed. Rep., 889.

Symmes *vs.* Union Trust Co., 60 Fed. Rep., 830.

Securities Co. *vs.* Louisiana Elec. Light Co., 68 Fed. Rep., 673.

Church *vs.* Citizens' Street R. Co., 78 Fed. Rep., 526, 530.

Railroad Co. vs. *Howard*, 7 Wall., 392, was a case of a foreclosure sale of a railroad by agreement between the mortgagees and the stockholders, the stockholders surrendering their stock and receiving certificates of interest in favor of "bearer," to the extent of 16 per cent. of the par value of their stock, while general creditors were cut off entirely. This Court held that the interest sought to be preserved to the stockholders was subject to the claims of general creditors. Answering the objection that the certificates of interest were negotiable, and might be in the hands of innocent holders, Mr. Justice CLIFFORD said (p. 415):

> "Written contracts are not necessarily negotiable simply because by their terms they enure to the benefit of the bearer. Doubtless the certificates were assignable, and they would have been so if the word bearer had been omitted, but they were not negotiable instruments in the sense supposed by the appellants. Holders might transfer them, but the assignees took them subject to every equity in the hands of the original owner."

In *Da Ponte* vs. *Louisiana State Lottery Co.*, Fed. Cas., 3569, Judge BILLINGS said:

> "There is still another impediment which, it seems to me, stands in the way of complainant's bill. It is the acquiescence on the part of those under whom he claims to derive his title, in this contract and their continued appropriation of its fruits. * * * Every successive shareholder (including the plaintiff's vendor) has assented to it and availed himself of it and it commenced, originally, upon the consent of the whole of the corporate body. No stockholder can now repudiate it as not authorized and not warranted."

In *Venner* vs. *Atchison, &c., R. Co.*, 28 Fed. Rep., 581, the complainant, suing as a stockholder, complained of a transaction whereby the defendant company, having already a capital stock of $34,000,000, doubled it and distributed $15,720,000 of the increased stock among its

stockholders, *pro rata*, without consideration. It was, of course, true that at the time of this issue of increased stock there was an intention to sell shares to subsequent purchasers, and the complainant was one of those purchasers. Judge BREWER said (p. 591):

> "Now, assuming that this action of the defendant Company, in 1881, in doubling its stock, was unauthorized, who may challenge it? Undoubtedly the State can at any time, because it holds a supervising control over the action of all its corporations, and may, by suitable proceedings, compel all to keep within the limits of the powers it has granted to them. So might any one of the then stockholders who did not vote for or voluntarily accept the benefits of such action, providing, at least, he commenced early, and before vast rights and obligations had become vested and assumed on the faith of its validity. No action has been taken by any such parties. The complainant purchased his stock and became interested in the defendant company years after such action had been taken, after it had been acquiesced in by the State and all parties in interest, and after rights and obligations to an enormous amount had been created and assumed on the strength thereof. Indeed, for aught that appears, the stock which he holds may be stock issued solely by virtue of such action, and it would be an anomaly for the holder of such stock to deny the validity of the act which gave it birth, or, with only such standing, be permitted to restrain the full exercise of the powers claimed thereby. Even if we may presume that his purchase was of stock of an earlier issue and of an unquestioned validity, he simply stands in the shoes of one who either directly voted for, or ratified by receiving the benefits of such action, and will not be heard to now question its validity. He bought into the company with full knowledge that the authorized capital stock claimed by this company was $68,000,000; that this amount of stock was authorized by the direct action of a majority of the stockholders, and the ratifying approval of all through their receipt of a proportional share of the increase."

Stewart vs. *St. Louis, &c., R. Co.*, 41 Fed. Rep., 736, was a suit on certain promissory notes of the defendant company given under the following circumstances: One Carter was the owner of a road-bed which cost originally about

$2,000. Two directors of the defendant company bought this road-bed for $15,000 and re-sold it to their company for $200,000 in notes and $3,600,000 in stock. They, of course, had an intention to sell the stock to the public, and it was in the interest of subsequent purchasers of the stock that the corporation afterwards set up a defense against the notes. At the time of the sale there were no stockholders and no stock was at any time issued or subscribed, except the $3,600,000 of stock under the said purchase. The only assets of the company were its charter and the road-bed. The company paid $120,000 of the notes and then defended against the remaining $80,000 on the ground of fraud. Judge FOSTER said (p. 738):

> "All parties—directors and stock holders, assented to it; and, surely, subsequent purchasers of stock, or the corporation itself, cannot now object to it. * * * The records of the company showed the transaction. It was not kept a secret. There was no law compelling any person or municipality to take stock in the company unless they voluntarily chose to do so; and if they were deceived by misrepresentations of the officers their cause of action rests on that deception and not on an attack on the original contract of purchase."

In *Securities Co.* vs. *Louisiana Electric Light Co.*, 68 Fed Rep., 673, Judge PARDEE said (p. 675):

> "I may say, further, that, as a general proposition, the purchaser of stock in a corporation is not allowed to attack the acts and management of the company prior to the acquisition of his stock; otherwise, we might have a case where stock duly represented in a corporation consented to and participated in bad managment and waste, and, after reaping the benefits from such transactions, could be easily passed into the hands of a subsequent purchaser, who could make his harvest by appearing and contesting the very acts and conduct which his vendor had consented to."

In *Church* vs. *Citizens' Street R. Co.*, 78 Fed. Rep., 526, the bill alleged that in 1893 two individuals, McKee

and Verner, purchased the entire capital stock of the railroad company; that through dummies, whom they placed in office as directors, they caused the stock to be increased by 35,000 shares, which were given to McKee and Verner without any consideration whatever; that they caused bonds to be issued and sold, out of the proceeds of which they reimbursed themselves for the entire amount paid for the stock; that they employed artifices known to those who deal upon stock boards to give the bonds and stocks an artificial value for the purpose of unloading them on the public; that plaintiffs in good faith, and without knowledge of this fraudulent scheme, purchased stock of the company in the open market two years later, at the price of 45¼ cents on the dollar of its par value; that some of the stock so purchased was of the original issue, which was lawful, and some was of the subsequent issue, which was fraudulent and illegal, but that plaintiffs were unable to discriminate between the shares. The bill alleged that plaintiffs were willing to turn in for cancellation all the fraudulently issued shares that might be found to be in their possession, and prayed that all other stockholders be required to do the same. JUDGE BAKER, in an oral opinion sustaining a demurrer to the bill, said (p. 530):

> "It is further objected that the plaintiffs in this case, having become purchasers of the stock, although they were good-faith purchasers of it, took it and hold it by no better or different title than the transferor of it to them. It is clear that the shares of stock in a corporation are not governed by the law merchant, nor are they governed by the statute of this State touching bills of exchange and notes made payable in a bank in this State. Securities of that character, in the interest of commerce and commercial dealings, are placed upon such a footing that if they reach the hands of an innocent purchaser

for value, before maturity, the holder acquires them by a new and indefeasible title, which enables him to collect the contents of such bills or promissory notes without regard to the defenses, legal or equitable, existing between the original parties to them. But stocks are *mere choses in action*, governed by the principles of the common law, and by the common law such choses in action are no better or higher evidence of title or right in the hands of an assignee than they were in the hands of the assignor. That is the general rule—a rule that, in my judgment, is applicable to this case—and, without a reference to the adjudications that have been read to the Court, the Court would have reached the same conclusion by the application of the general principles of law with which the members of the bar as well as the Court are familiar. So that in this case I see no principle of the law that would authorize the plaintiffs to maintain the present bill on the ground that the stock that they had purchased, by the transfer or assignment of it, had acquired some new rights or equities that the stock did not possess in the hands of the transferor or assignor."

There is in New York a long line of decisions holding that as to matters affecting the collective interest, each stockholder, irrespective of actual knowledge, is bound by the acts or acquiescence of his predecessors in title.

Kent *vs.* Quicksilver Mining Co., 78 N. Y., 159, 188.
Matter of Syracuse, &c., R. Co., 91 N. Y., 1, 4.
Langdon *vs.* Fogg, 14 Abb. N. C., 435.
Parsons *vs.* Hayes, 18 J. & S., 29, 38.
Hollins *vs.* St. Paul, &c., R. Co., 9 N. Y. Supp., 909.
Drake *vs.* Suburban Water Co., 26 App. Div., 499.
Campbell *vs.* American Zylonite Co., 122 N. Y., 455.
Barr *vs.* Railroad Co., 125 N. Y., 263.
Elyea *vs.* Lehigh Salt Mining Co., 169 N. Y., 29, 33.

The case last cited was a stronger case than that of a mere transferee. It was a case of a pledgee of stock object-

ing to corporate action taken without his knowledge, during the continuance of the pledge, by the pledgor, who was the registered stockholder, consenting to a sale of all the corporate property. The Court said (p. 33):

> "Certainly, what the stockholders might have done by the requisite vote at a formal meeting they might do by agreement between themselves, to which the assent of every one was obtained. They were the corporation and the proprietors of the corporate interests, and, acting collectively, no action of a formal nature could be more binding in disposing of corporate properties. * * * The plaintiff is in no position to object. The statute under which the company was organized recognizes only the pledgor of stock, when it still remains registered in his name on the books, as being competent to vote at corporate meetings, and it follows if his acts in that form would be binding, that a contract with third persons entered into by him, in union with the other stockholders, will be binding on his pledgee and assignee."

In *Drake* vs. *New York Suburban Water Co.*, 26 App. Div., 499, it appeared that a water company, having no creditors and only three stockholders, with the consent of two of the stockholders and without objection on the part of the third, entered into a contract for the construction of its plant. By this contract it was provided that the balance of its entire issue of stock should be paid to the contractors in addition to bonds exceeding in par value the cost of the work. It was held that the transferee of a sub-contractor who received in payment for services rendered some of the stock so issued to the contractor, could not complain that the contract was in fraud of the rights of stockholders. The Court said (p. 510):

> "The company contracted, it obtained that for which it contracted, and no person or corporation then in existence, or which subsequently came into existence as an interested party, can be heard in complaint of a transaction by which no person was defrauded, and each obtained what it contracted to obtain."

In answer to a claim by the sub-contractor that he rendered service directly to the company, and that he stood on the footing of an original subscriber for shares, the Court said (p. 511):

> "But such statement does not change the fact that the work which he did was of a character which Inman Bros. were to perform under the contract. He knew such was the fact, rendered the service and received the pay from the stock which passed through them. Huss, therefore, stood upon no other or different footing than the other holders. His transferee could acquire no other rights than he held. (Cook Stock & Stockh., Sec. 40, and cases cited in note.) If the stock issued to Inman Bros. was invalid, then it follows that the stock issued to Huss was also invalid and could not be made to furnish a basis for this action. We think, however, that this stock was valid at the time of its issue, and in its entirety it remains untainted with any vice."

A like conclusion has been reached by the Courts of last resort in several other states.

Brewing Co. *vs.* Schneider, 110 Mo., 83.

Clark *vs.* American Coal Co., 86 Ia., 436; 17 L. R. A., 557.

Spokane *vs.* Amsterdamsch Trustees, 22 Wash., 172.

Erny *vs.* G. W. Schmidt Co., 197 Pa. St., 475.

Higgins *vs.* Lansingh, 154 Ill., 301.

Trimble *vs.* American Sugar Refining Co., 61 N. J. Eq., 340.

Wells *vs.* Northern Trust Co., 195 Ill., 288, 296.

Hodge *vs.* U. S. Steel Corporation, 64 N. J. Eq., 90.

Home Fire Ins. Co. *vs.* Barber, 93 N. W. Rep., 1024; 60 L. R. A., 927.

McCampbell *vs.* Railroad Co., 111 Tenn., 55.

Marvin *vs.* Anderson, 111 Wisc., 388.

Brewing Co. vs. *Schneider*, 110 Mo., 83, was a case where all the stock of a corporation was owned by three persons. They made an agreement by which two of them were to buy the stock owned by the third, to be paid for in part by the proceeds of a note given by the corporation and the remainder by notes of the purchasers. It was held that payment of the notes out of the earnings of the company could not be successfully assailed by stockholders who inherited their stock from one of the parties, nor by those who became stockholders after the payments were made. The Court said (page 89):

> "We again re-assert the rule that officers of a corporation will not be allowed to deal with the funds and property of the corporation for their private gain, but the rule has no application to a case like the one in hand. Schilling and Schneider had a perfect right to buy the stock. After that purchase they owned all the stock and it was entirely competent and proper for them to agree that it should be paid for out of the earnings of the corporation."

And again at page 90:

> "These plaintiffs are in no condition to complain of that act. Some of them inherited the stock owned by them from Schilling and stand in his shoes, and surely he could not complain of his own act. The assignees from other heirs of Schilling stand in no better position, for they did not acquire their stock until the dividends had been declared and paid."

Clark vs. *American Coal Company*, 86 Ia., 436; 17 L. R. A., 557, arose out of the action of the directors of the defendant company in declaring a stock dividend of 900 per cent., out of which they transferred a large block of stock to the fuel agent of a railroad company for the purpose of influencing him in the purchase of coal. The action was taken upon the consent of all persons then interested in the company. The Court said (page 561):

> "We think the contract at its inception was against public policy,

and voidable at the instance of a party prejudicially affected thereby. We do not, however, think the plaintiff is such a party. Were the conditions now such that because of the reasons for which the contract might be declared against public policy, the plaintiff was liable to prejudice, the Courts would not wait for prejudice to result before granting relief, but would grant the relief to avoid the prejudice. In May, 1889, Wood disposed of his stock, and has not since been connected with the corporation. Nothing in the present organization is against public policy, nor is there anything to satisfy us that the plaintiff has been at any time in the least prejudiced because of Wood's connection with the corporation. Because the contract was in the first instance voidable is no reason for now saying that all acts done in the organization of the corporation, its business, and the disposition of stock and dividends must be declared void without some reason for so doing; and it may well be said in this connection that the plaintiff is not seeking to have the contract declared void. The contract if void would go to the entire transaction of incorporating, for it lies at the very foundation of it, and would nullify the entire issue of stock, including that of the plaintiff."

Spokane vs. *Amsterdamsch Trustees*, 22 Wash., 172, was a case like *Elyea* vs. *Lehigh Salt Company* (*supra*). A pledgee of corporate stock complained of the action of the pledgor in consenting to a sale of all the corporate property. The Court held the pledgee bound by the consent of the pledgor.

In *Higgins* vs. *Lansingh*, 154 Ill., 301, it appeared that one Benson sold to a cemetery corporation, of which he was a manager, with the assistance of two other managers, his equity in certain lands which were subject to indebtedness considerably exceeding their market value. The consideration received was stock and scrip to the amount of $150,000. The scrip represented a conditional interest in 937 shares of stock, which were pledged to secure a part of the indebtedness against the land. The company had no assets other than the lands conveyed to it by Ben-

son. Certain stockholders brought suit to redeem the 937 shares held in pledge, and the suit was defended on the ground that the stock held by complainants was fraudulently issued. The Court said (p. 332):

> "We are of the opinion that it was lawful for Benson, with the consent of his creditors, to devote these lands to the purposes of a cemetery through the instrumentality of this corporation, and, the lands being the only capital of the company and there being then no other stockholders or creditors to complain, to take and receive from the company certificates representing all of the capital stock, even though their face value was far beyond the value of the lands. It was a mere change from private to corporate ownership of the land."

In *Wells* vs. *Northern Trust Co.*, 195 Ill., 288, a foreclosure suit founded upon mortgage bonds issued pursuant to a construction contract was defended upon the ground that said bonds constituted fictitious indebtedness fraudulently incurred contrary to the constitution of Illinois. The Court said (p. 296):

> "The contract with the construction company was authorized by all the stockholders and the mortgage was authorized by the unanimous vote of all the stock of the company. It is not shown that there were then any stockholders or creditors who were injured by this action against their consent. All then interested in the company having assented to the contract and its modification, and to the mortgage and the issuing of the bonds, the company and the successors in interest of the then stockholders are estopped from setting up the inequality or oppressiveness of the construction company's contract."

In *Erny* vs. *G. W. Schmidt Co.*, 197 Pa. State, 475, it appeared that the President of the corporation had withdrawn moneys from its treasury, a large proportion of which he had used for the benefit of the corporation and the remainder for his own benefit. These acts were done without concealment, and the withdrawal of such

moneys had been acquiesced in by the corporation and its stockholders for more than two years. After the expiration of the two years plaintiff purchased stock from an unregistered pledgee of the stock who had participated in the transactions in question. The purchaser, who afterwards became complainant in the suit, was not shown to have had any knowledge of these transactions at the time when he purchased the stock. The Court said (page 491):

> "It is sufficient to say of Erny that as he purchased his stock after the alleged mismanagement had been acquiesced in by the company for a period of nearly two years he has no just cause to complain."

In *Trimble* v. *American Sugar Refining Co.*, 61 N. J., Eq. 340, Vice-Chancellor PITNEY held that upon an application for a preliminary injunction to restrain alleged *ultra vires* employment of the funds of the corporation, the plaintiff, being the owner of only a small portion of the capital stock, ought to show affirmatively that neither he nor his predecessor in title had acquiesced in the policy of which he complained.

In *Hodge* v. *U. S. Steel Corporation*, 64 N. J. Eq., 90, Vice-Chancellor EMERY applied the same rule, saying (page 92):

> "If such previous holders of either the Smith or Curtis shares have assented then neither Smith nor Curtis is entitled to a preliminary injunction against the execution of the plan assented to so far as their rights rest on the ownership of these shares."

In *Home Fire Ins. Co.* vs. *Barber*, 60 L. R. A., 927, the question now under consideration was very carefully considered by the Supreme Court of Nebraska. The Court said (page 935):

> "The fallacy in the view that one who has not been injured by a transaction and is not affected thereby can acquire a right to sue in equity to

set it aside because he has acquired the shares of the person injured, is exposed in the case of Graham *vs.* LaCrosse & M. R. C., 102 U. S., 148, and Hoffman *vs.* Bullock, 34 Fed., 248. The right to complain of such transactions is one which the stockholders injured may or may not exercise, as they choose; where such transactions are not absolutely void they may, if they so elect, acquiesce and treat them as binding. The discretion whether to sue to set them aside or to acquiesce in or agree to them is incapable of transfer."

And again on the same page:

"It appears to be well settled also that stockholders who have acquired their shares and their interest in the corporation from the alleged wrongdoers and through the prior mismanagement have no standing to complain thereof. * * * If a stockholder's predecessor in title has acquiesced in a course of mismanagement, it has even been held that he cannot maintain a suit to restrain its continuance."

In *McCampbell* vs. *Railroad Company*, 111 Tenn., 55, it appeared that the defendant Railroad Company had been exceeding its corporate powers by purchasing and holding the stock of a Land Company and by endorsing notes for the accommodation of such company. The plaintiffs were persons who had acquired their stock from participants in the transaction and they sought by a bill in equity to have the transaction set aside and to recover for the benefit of the corporation the money paid for the Land Company's stock. The Court held that the complainants were entitled to no relief as to past transactions, although they might have a right to enjoin a continuance of such acts in the future. The Court quoted with approval the language of Mr. Morawetz at Section 267 of his work on *Private Corporations:*

"A purchaser of shares acquires no greater rights than the prior holder. If a violation of corporate rights is acquiesced in by all the other holders of stock, the action becomes extinguished thereby and no other holders, present or future, would be entitled to complain."

The views of the leading text writers are all in harmony with those expressed by Mr. Morawetz in the passage last quoted.

In 4 *Thompson on Corporations*, page 3410, the learned author says:

> "But as share certificates do not, under any theory, rise to the grade of strictly negotiable paper, it should follow, and especially in regard of the transfer of any litigious rights which may attach to them, that their holder cannot, by selling them to another, transfer to that other any better litigious rights, inhering in them, than he himself possesses. If, therefore, he has, by his conduct as a shareholder, estopped himself from maintaining a suit in equity to undo corporate action, which he might otherwise have maintained, this estoppel will attend the shares in the hands of his vendee."

In 2 *Clark & Marshall on Corporations*, Section 557, the learned authors say:

> "And it is also established by the weight of authority that a transferee of shares is in the same position as his transferor with respect to suing on account of transactions prior to the transfer, even when he is a purchaser without notice, and that he is estopped to sue therefor without regard to his good faith if his transferor was estopped."

In 2 *Cook on Corporations*, Section 730, the learned author says:

> "Moreover, a stockholder who holds stock which has been voted in favor of the act complained of, cannot bring suit as the holder of that stock. A purchaser or pledgee of stock cannot complain of mismanagement and loss of funds which all the stockholders acquiesced in prior to his purchase or pledge."

Opposed to these authorities is a single American decision, *Parsons* vs. *Joseph*, 92 Ala. 403, which holds that a transferee of stock is not estopped from complaining of corporate transactions acquiesced in by his predecessor in title, where he did not know of such acquiescence at the time he purchased the stock. This was a decision rendered practically on demurrer, and it

did not appear that the corporation had lost its right of action through the acquiescence or consent of all its stockholders, but only that the immediate predecessor in title of the plaintiff was personally disqualified from maintaining a suit. The decision was founded on a peculiarity of the local law of Alabama, whereby a derivative purchaser without notice cannot be affected by notice to him under whom he claims; and if he purchase with notice he may protect himself by the want of notice in his immediate vendor. This principle was first enunciated in reference to lands (*Fenno* vs. *Sayre*, 3 Ala., 458) then extended to slaves (*Weer* vs. *Davis*, 4 Ala., 442; *Horton* vs. *Smith*, 8 Ala., 78) and finally applied to a note and mortgage regarding which the evidence did not show whether or not it was past due when it was assigned (*Martinez* vs. *Lindsey*, 91 Ala., 334).

In England there appear to be but two decisions bearing upon this question. They are opposed to one another in spirit, although not necessarily irreconcilable in regard to the actual point decided.

Ffooks *vs.* London & Southwestern Railroad Co., 1 Sm. & C., 142.

London Trust Co., Ltd., *vs.* MacKenzie, 68 Law Times, 380.

The decision in the case last cited is by WRIGHT, *J.*, and evidently resulted from a failure to discriminate between the particular rights of a shareholder, as against the corporation, in respect to the amount due on his stock, &c., and the collective rights of all the shareholders, as members of the corporation, in respect to matters of their common interest. According to the great weight of

authority, it is only in respect to matters of the latter character that a transferee is estopped by the acts or acquiescence of his predecessor in title, of which he had no knowledge.

Campbell *vs.* American Zylonite Co., 122 N. Y., 455.

Even if it be conceded that the law of England on this question stands in doubt, it is beyond all dispute the settled law of this country that a corporation is estopped from questioning a contract or a transfer of property which was concurred in by all its stockholders at a time when it had issued all the stock which it intended to issue. This principle has become a rule of property and is the foundation of many titles. It cannot be disturbed now without grave injustice.

To hold otherwise would be to deprive corporations of a freedom of action which in some cases may be most necessary for their preservation. A corporation which can do nothing by unanimous consent which it could not do by the bare will of a majority of its members, is poorly equipped to meet financial difficulties and emergencies. To constitute every stockholder a trustee for all his successors in interest would make it perilous for him to give his consent to any corporate action, when a refusal of consent was possible. Those successors in interest are unknown, remote and unascertainable. They have no sympathy with present difficulties, and they have the privilege of ratifying or condemning after the event. A corporation composed exclusively of trustees for such beneficiaries would be a timid and unmanageable affair. An aggregation of distrustful and antagonistic elements, each for-

bidden by ironclad rules to waive anything, or to concede anything, would be poorly constituted to win profit for its members or do service to the State.

XV.

The order of the Circuit Court for the District of Kentucky was not effective to authorize the Receiver to maintain a suit in the name of The Great Western Mining and Manufacturing Company, in the Circuit Court for the District of Vermont.

The Receiver was a mere instrument of the Court which appointed him, for the exercise of its ordinary jurisdiction in equity. The order continuing the receivership *pendente lite* appears in the Record, at page 364. The nature of the suit in which the Receiver was appointed does not appear, otherwise than from a statement in the minute book of the corporation (Rec., 362):

> "Mr. Carlisle reported that his failure had compelled an application to the U. S. Court for the appointment of a receiver of the company, by reason of his name being endorsed on the company's notes for coal purchased and the holders of said notes bringing suits and attachments against the company, the application was made in order to save the property and prevent its being sacrificed."

It is not alleged that any assignment or transfer of its property to the Receiver was ever made by The Great Western Mining and Manufacturing Company. The complete minute book of the corporation is in evidence (Rec., 177, 297 to 364), and thereby it affirmatively appears

that no authority was ever given to the Receiver, by any corporate action, to file this bill in the name of The Great Western Mining and Manufacturing Company. The Receiver has no statutory title to the property of the corporation, nor any statutory right to sue in its name. The only justification of the Receiver's action in making use of the name of the corporation for the purpose of this suit is found in the order of the Circuit Court for the District of Kentucky, as follows (Rec., 367):

> "And it appearing to the court that it will be for the advantage of the said company that suit shall be instituted against the stockholders and directors of the same for the recovery of the sums so represented to be lost, it is therefore directed that said receiver proceed in his own name as receiver, or in the name of the company as he may be advised to recover said sums."

There were both stockholders and directors of this corporation in the District of Kentucky at the time said order was made; but, so far as the record shows, no proceedings were instituted in said district, in pursuance of said order. But in the District of Vermont a bill was filed in the name of The Great Western Mining and Manufacturing Company, not authenticated by its seal nor verified or signed by any of its officers. The signature to the bill was (Rec., 7):

> "The Great Western Mining and Manufacturing Company,
> By L. C. Black, its Receiver,
> By Dillingham, Huse & Holland,
> Plaintiff's Solicitors."

Both in the bill itself (Rec., 7) and at sundry stages in the progress of the cause (Rec., 27, 31, 195, 198), and in his petition to this Court (p. 2), the receiver claimed to have authority, by virtue of the above-mentioned order,

to conduct this cause as complainant, in the District of Vermont, even to the extent of signing an appeal bond in the corporate name (Rec., 198).

Now the act of signing the name of another, without his consent, to a bill of complaint or to an appeal bond, is an act which requires affirmative justification. When the act is done in the District of Vermont, and the object of the act is to get possession of property having a situs in said District, and the justification relied on is the official character of the Receiver and the order of the Circuit Court for the District of Kentucky authorizing such act, obviously the question arises whether or not the court last mentioned has power, for such a purpose and in such a manner, to invest its agent with authority for the performance of an official act in a foreign jurisdiction.

The Circuit Court for the District of Kentucky was not advised by the receiver's petition that any action by the receiver outside the District of Kentucky would be necessary. Its order did not expressly authorize such action outside the District. The order was one which could have been acted on within the District. There was clearly no intention on the part of the Circuit Court to exceed its jurisdiction, and therefore its order cannot be construed as authorizing the filing of the present bill unless it was actually within the power of the Court to affect the possession of property having a situs in Vermont, by determining the question, who should be empowered to sue therefor. The right to sue involves the right to demand; the right to demand implies the right to receive. Therefore an order of the Circuit Court for the District of Kentucky, if such an order had been made, determining the

question as to who should bring suit for this property in Vermont would be sustainable only on the theory that the Court had jurisdiction to determine who should ultimately receive possession of the property in Vermont.

The powers of the Court are not enlarged by acting through an agent. The Court cannot empower its officer to accomplish a result which it is beyond the Court's jurisdiction to accomplish, merely by instructing its officer to clothe his official acts in a new form of words. No matter what form a receiver's proceedings may take, if they are justifiable only by reason of his official character, they are subject to all the inherent limitations affecting the jurisdiction of the Court by which he was appointed. The receiver cannot shelter himself behind his official character as an excuse for acts which otherwise would be unlawful, while at the same time he disregards the limitations by which the jurisdiction of the appointing court is circumscribed.

The petitioner recognizes the general principle that the Circuit Courts of the United States have no power by direct decree to affect the title to or the right to possession of real or personal property outside their respective districts. He recognizes also the principle that receivers appointed by these courts, in the exercise of their general jurisdiction, have no extra-territorial power of official action. But he claims, in effect, that these rules are subject to an exception sufficiently broad, in its practical operation, to nullify both rules. He claims that the Court, by appointing a receiver and by investing such receiver with the power to use the name of a party to the suit may, in effect, enable such receiver to do officially in a foreign

jurisdiction all that any party to the suit could there do in his individual capacity.

Such an exception to the accepted rules of jurisdiction can be justified only on the ground of comity. When an act is done in any jurisdiction which is unlawful there, unless justified; and when the jurisdiction relied on is the order of a court of some other jurisdiction, the question whether such order shall be deemed effective to justify the act is a question of comity. We are brought back, therefore, by the petitioner's contention to the precise question which was decided by this Court, after great deliberation, in *Booth* vs. *Clark*, 17 How. 322.

The principal question in that case was whether the courts of the United States should adopt the rule of comity, which was alleged to be practiced by the courts of England, in respect to giving an extra-territorial effect to foreign judicial decrees and provisional remedies in cases of bankruptcy and insolvency. The precise question in that case related to the right of the receiver of the property of a judgment debtor appointed by the Court of Chancery of New York in a judgment creditor's suit, to maintain a suit in the Circuit Court of the United States for the District of Columbia to recover the judgment debtor's share in a claim upon Mexico which had been adjudged in his favor by Commissioners acting pursuant to a treaty. That the receiver was without power to maintain such a suit, unless by comity, was a proposition which this Court did not regard as open to debate. Mr. Justice WAYNE, after tracing the course of the decisions in England upon this point, said (p. 336):

"So the law stood in England until the case of *Folliot* vs. *Ogden*, 1 H.

Bl., 123, when Chancellor Northington stimulated it into a larger comity by giving effect to a claim of the creditors of a bankrupt in Amsterdam over an attaching creditor in England, who had proceeded after the bankrupt had been declared to be so by the proper tribunal in Amsterdam. England had just then become the great creditor nation of Europe, and of her provinces in North America. Her interest prompted a change of the rule, and her courts have ever since led the way in extending a comity which had before been denied by them."

The learned Justice then proceeded to show that this Court was not constrained, by judicial precedent, or by any settled course of practice in this country, to adopt the English rule. He then referred to the inconvenience which might result from the operation of the proposed rule of comity (p. 337):

"The courts of the United States will not subject their citizens to the inconvenience of seeking their dividends abroad, when they have the means to satisfy them under their own control. We think that it would prejudice the rights of the citizens of the States to admit a contrary rule. The rule, as it is with us, affords an admitted exception to the universality of the rule that personal property has no locality, and follows the domicile of the owner. This Court, in Ogden *vs.* Saunders, 12 Wheat., 213, disclaimed the English doctrine upon this subject; and in Harrison *vs.* Sterry, 5 Cranch R., 289, 302, this Court declared that the bankrupt law of a foreign country is incapable of operating a legal transfer of property in the United States."

The practical objections to the proposed rule of comity were stated at greater length on pages 338 and 339, as follows:

"We think that a receiver could not be admitted to the comity extended to judgment creditors, without an entire departure from chancery proceedings, as to the manner of his appointment, the securities which are taken from him for the performance of his duties, and the direction which the court has over him in the collection of the estate of the debtor, and the application and distribution of them. If he seeks to be recognized in another jurisdiction, it is to take the fund there out of it, without such court having any control of his

subsequent action in respect to it, and without his having even official power to give security to the court, the aid of which he seeks, for his faithful conduct and official accountability. All that could be done upon such an application from a receiver, according to chancery practice, would be to transfer him from the locality of his appointment to that where he asks to be recognized, for the execution of his trust in the last, under the coercive ability of that court; and that it would be difficult to do, where it may be asked to be done, without the court exercising its province to determine whether the suitor, or another person within its jurisdiction, was the proper person to act as receiver."

The Court concluded that the receiver appointed by the court of chancery of New York had no standing to maintain his suit in the District of Columbia, and that the learned Circuit Court was right in dismissing the bill.

The decision in *Booth* vs. *Clark* has not been generally followed in the courts of the several States. A majority of them have their own rule of comity, sometimes clearly defined, and in other cases loose and uncertain. In some States a foreign receiver may sue, provided he shows by his bill that there are no domestic creditors who can be prejudiced by the suit. In other States there is a race of diligence. If the domestic creditors get into court first they will be protected; but if the foreign receiver sues first, the Court will not stop to inquire whether there are any domestic creditors. In Massachusetts, according to the allegation of the petitioner, the exercise or non-exercise of comity depends upon the employment of a form of words, not affecting the substantial rights of any one. In other States, for all we know, it may depend on the condition of the weather or the personal opinion of the particular judge who happens to hear the case. In *Alderson on Receivers*, § 228, is an interesting collection

of cases from State courts, showing the chaotic condition of the decisions on this subject. They are unworthy of discussion in detail, because they are incapable of shedding any light upon the rules of law applicable to those courts in which *Booth* vs. *Clark* was of binding effect as an authority.

It may be observed, however, that the States which were first to adopt this rule of comity, and which have been most emphatic in commending it, are those which occupy a position somewhat analagous to that of England in 1811, as stated in the above-quoted opinion of Justice WAYNE.

In the Federal courts it has never been doubted that *Booth* vs. *Clark* was conclusive against the right of receivers to sue in the courts of the United States, outside the State or district in which they were appointed.

Brigham *vs.* Luddington, 12 Blatchf., 237.
Kittel *vs.* Augusta, &c., R. Co., 78 Fed. Rep., 855.
Hazard *vs.* Durant, 19 Fed. Rep., 471.
Philadelphia, &c., Iron Co. *vs.* Daube, 71 Fed. Rep., 583.
Wigton *vs.* Bosler, 102 Fed. Rep., 70.

The only Federal case to the contrary, *Hale* vs. *Hardon*, 95 Fed. Rep., 747, was overruled in *Hale* vs. *Allinson*, 188 U. S., 56, and *Hilliker* vs. *Hale*, 117 Fed. Rep., 224 (certiorari refused, 188 U. S., 739).

In *Hale* vs. *Allinson*, 188 U. S., 56, the suggestion was made by counsel that the authority of *Booth* vs. *Clark* had been weakened by the passage of time and by the numerous

decisions in State courts recognizing a rule of comity whereby receivers were permitted to sue outside the jurisdiction of the courts which appointed them. But this Court said:

> "We do not think anything has been said or decided in this Court which destroys or limits the controlling authority of that case."

Mr. Justice PECKHAM then quoted from *Booth* vs. *Clark* the following words, among others, in regard to the powers of a receiver (p. 68):

> "He has no extra-territorial power of official action; none which the Court appointing him can confer, with authority to enable him to go into a foreign jurisdiction to take possession of the debtor's property; none which can give him, upon the principle of comity, a privilege to sue in a foreign court or another jurisdiction, as the judgment creditor himself might have done, where his debtor may be amenable to the tribunal which the creditor may seek."

And the learned Justice added:

> "This statement has not been overruled or explained away by any subsequent decision of this Court to which our attention has been called."

In *Hilliker* vs. *Hale*, 117 Fed. Rep., 220, it was said by the learned Circuit Court of Appeals for the Second Circuit (p. 224):

> "We are further of the opinion that the plaintiff cannot maintain this action. He sues as receiver. His rights, if any, rest wholly upon the order and decree in the Rogers Case. Without regard to the nature of the claim asserted against the defendant, the plaintiff has no relation to that claim otherwise than through such order and decree. He is not the assignee of all or any of the creditors. He has no title to anything, so far as appears, except to his office of receiver. The order and decree, in terms, make him a mere agent of the Minnesota court. That court undertook to authorize him to sue non-residents in other jurisdictions; moneys collected to be 'held by him subject to the further order of this court (the Minnesota court) in the premises.' The Minnesota court thus attempted to send its agent to collect money by suit outside of its jurisdiction, and to bring it back to be disposed of as it might direct. If it

had had power to transfer the claim against the defendant to the plaintiff, and had in fact so transferred it, he could assert the title thus acquired and sue upon such claim here in accordance with the principles stated in Association *vs.* Rundle, 103 U. S., 222, 26 L. Ed., 337. Apparently the court had no such power. Whether it had or not, it did not attempt to exercise it. It transferred nothing to the plaintiff. It merely appointed him its own agent to collect and hold subject to its order. He was made an arm of the court, with which the court attempted to reach outside of its territorial jurisdiction, and the attempt, it seems to us, was futile. The court could not reach beyond the limits of its jurisdiction through a receiver any more than it could through a marshal or a sheriff. The authority which it sought to give to the plaintiff became a dead letter when he passed beyond the boundaries of the State. This is substantially what was held in Booth *vs.* Clark, 17 How., 322, 15 L. Ed., 164, which has never been reversed."

With the conclusion thus reached this court declined to interfere upon a petition for certiorari (188 U. S., 739).

Constrained by the authority of *Booth* vs. *Clark*, the courts of the United States have built up a system of procedure for dealing with the affairs of insolvent corporations, which rests upon firmer ground than that of comity, and which avoids the practical objections pointed out in *Booth* vs. *Clark*, while securing to foreign creditors reasonable facilities for the collection of their debts. The system which has thus been evolved has the spirit of comity, but is made effective through the exercise by each court of its own jurisdiction, rather than by the abdication of jurisdiction on the part of any court in favor of another. Some cases which illustrate its growth and the principles upon which it proceeds are:

Parsons *vs.* Charter Oak Life Ins. Co., 31 Fed. Rep., 305.

Mercantile Trust Co. *vs.* Kanawha, &c., R. Co., 39 Fed. Rep., 337.

Platt *vs.* Philadelphia & R. R. Co., 54 Fed. Rep., 569.

Central Trust Co. *vs.* East Tennessee, &c., R. Co., 69 Fed. Rep., 658.

Ames *vs.* Union Pacific R. Co., 60 Fed. Rep., 966.

Bayne *vs.* Brewer Pottery Co., 82 Fed. Rep., 391.

Sands *vs.* E. S. Greeley & Co., 88 Fed. Rep., 130.

Reynolds *vs.* Stockton, 140 U. S., 254.

In re Brant, 96 Fed. Rep., 257.

Shinney *vs.* North American Savings, &c., Co., 97 Fed. Rep., 9.

Coltrane *vs.* Templeton, 106 Fed. Rep., 370.

Lewis *vs.* American Naval Stores Co., 119 Fed. Rep., 391.

Conklin *vs.* United States Shipbuilding Co., 123 Fed. Rep., 913.

In *Parsons* vs. *Charter Oak Life Ins. Co.*, 31 Fed. Rep., 305, where it was found that the contract rights of policy-holders required that all the assets of the corporation, wherever situated, should be collected into one fund and be equally distributed among the policy-holders, according to their respective rights, without regard to residence, it was held that the proper method of giving effect to such contract rights, as to assets situated in the southern district of Iowa, was to appoint a receiver ancillary to the receivers appointed by the court of the corporation's domicile, and to authorize such receiver to take possession of the assets, convert them into money, and remit the proceeds to the court of primary jurisdiction.

In *Mercantile Trust Co.* vs. *Kanawha, etc., R. Co.*, 39 Fed. Rep., 337, it was held by Justice HARLAN and Judge JACKSON, sitting together in the Circuit Court for the District of West Virginia, that ancillary receivers could be appointed only upon a regular bill of complaint, showing the equities of the complainant and investing the Court with jurisdiction to determine the incidental questions attaching to its possession of the property. Mr. Justice HARLAN said (p. 340):

"The request that this Court will simply confirm the appointment of a receiver, made in another circuit, and by its order invest that receiver with the possession and control of the mortgaged premises within this district—no other relief being contemplated—is, in effect, a request that this Court will compel all who have claims and rights in respect to the mortgaged property situated in West Virginia, to seek relief in the original suit for foreclosure pending in another State; and this, notwithstanding such parties may have the right, under existing legislation, to invoke the jurisdiction of this Court, or of some court of general jurisdiction established in this State. It might be well if Congress would so enlarge or regulate the jurisdiction of the courts of the United States as to enable a circuit court in which is brought an original suit for the foreclosure of a mortgage resting upon an interstate railroad to take actual possession, by its officers of the entire line, and of all the mortgaged property, wherever situated, and administer it for the benefit of all concerned; preserving in that mode the unity of the railroad, and the just rights of mortgagors, mortgagees, creditors, as well as those of the general public interested in commerce among the States. But there has been no such legislation, and we do not see our way clear to effect any such result by judicial orders merely.

A good deal was said at the argument about the injury that might possibly ensue to mortgagors, mortgagees, creditors and the public if an interstate railroad, covered by one mortgage, be placed under the management of different receivers, each acting under the orders of the Court appointing him, and sold under separate decrees, rendered in distinct foreclosure suits, brought in different circuit courts of the

United States. Undoubtedly railroad property of that kind could be very materially injured in value, and the general public put to serious inconvenience, if the courts in which such separate suits are brought decline to act in harmony, or according to some fixed plan, in the administration and sale of the property. It is not, however, to be assumed that this Court, if its jurisdiction is properly invoked in reference to this railroad, so far as it lies in West Virginia, will fail in any duty imposed upon it by law, or the comity prevailing between courts of equal dignity and authority."

The conclusion here stated was followed in *In re Brant*, 96 Fed. Rep., 257.

In *Platt* vs. *Philadelphia, &c., R. Co.*, 54 Fed. Rep., 569, it appears to be the practice in the District of Massachusetts and in many other districts to appoint ancillary receivers *ex parte* and without a close scrutiny of the bill of complaint.

In *Ames* vs. *Union Pacific R. Co.*, 60 Fed. Rep., 966, the respective rights and powers of the court of primary jurisdiction and of the courts exercising auxiliary jurisdiction were considered by Judges CALDWELL and SANBORN. The latter said (p. 974):

"It is unnecessary to discuss or decide here whether the circuit court sitting in Colorado or Wyoming is a court of ancillary jurisdiction in the matter of this receivership. These receivers were first appointed in this court sitting in Nebraska. So far as the general management of the trust imposed upon them, the general operation of the railroad system in their charge in this circuit, and their general accounting, is concerned, they must report to and be governed by this court sitting in Nebraska. The impracticability of properly administering this great trust under any other practice, and the intolerable confusion which would result from contradictory orders regarding these subjects made in the different districts in the circuit, will commend this rule of practice to every judge within the jurisdiction, and prevent any interference or modification of the orders issued in these matters by the Circuit Court for the district of Nebraska, except by appeal or upon rehearing; but the circuit courts in

the districts of Colorado and Wyoming have jurisdiction to hear and determine the claims of the citizens of those districts against the insolvent corporation and the receivers of it, and their determination of those matters will be equally respected by the court sitting in Nebraska. Citizens of one district will not be required to go to another district to assert their claims against receivers appointed by the courts of both districts."

In *Central Trust Co.* vs. *East Tennessee, &c., R. Co.*, 69 Fed. Rep., 658, it was held to be within the province of the Court exercising auxiliary jurisdiction to determine questions of priority of lien as against assets in the possession of the ancillary receiver. Judge NEWMAN said (p. 666):

"The rights of parties under the local law may be better ascertained in their respective jurisdictions than they would be if sent, as a whole, to the court of primary jurisdiction."

In *Bayne* vs. *Brewer Pottery Co.*, 82 Fed. Rep., 391, upon a question as to the personnel of the ancillary receivership, the learned Court quoted with approval from *Beach on Receivers* as follows (p. 395):

"A feature of ancillary receiverships is that the same person is generally, although not always or necessarily, appointed receiver. Thus his power becomes co-extensive in every jurisdiction wherein he is appointed, and a complete and uniform management of the property is secured."

In *Sands* vs. *E. S. Greeley & Co.*, 88 Fed. Rep., 130, the principles controlling upon Federal courts when their powers are invoked in aid of a receivership originating in some other court are stated by Judge WALLACE as follows (p. 132):

"When the administration extends over assets located in several jurisdictions it is often convenient to apply, in advance, for the assistance of the different courts; hence the practice has become common of applying for auxiliary or ancillary appointments. When such an application is made, the court to which it is addressed exercises its

own original jurisdiction. The decree in the court of the domicile of the corporation is evidence in every other state that the corporation is insolvent, and that a proper case exists in that state for the appointment of a receiver, and it is to be respected accordingly, in obedience to the constitutional provision whereby full faith and credit is to be given in each state to the records and judicial proceedings of every other state of the Union. But it is for the court to which the application is made to decide what remedy it should extend in the particular case, and whether the proper administration of the assets requires the appointment of a receiver. Ordinarily, in comity to the proceeding of another court of co-ordinate jurisdiction, it will appoint an ancillary receiver, and assume administration in aid of the primary receiver (Trust Co. *vs.* Miller, 33 N. J. Eq., 155). When it appoints a receiver the officer becomes its officer, and is completely amenable to its control, and it mattters not whether he is called an ancillary receiver or merely a receiver. His title to the assets within the jurisdiction is derived from its decree, and does not depend upon comity. The assets are in its custody, and are to be disposed of as equity and the orderly adminstration of justice require. Its judgments and decrees in respect to these assets must be accepted as conclusive by all other courts. 'Where a receiver, administrator, or other custodian of an estate is appointed by the courts of one state, the courts of that state reserve to themselves full and exclusive jurisdiction over the assets of the estate, within the limits of the state.' Reynolds *vs.* Stockton, 140 U. S., 254, 11 Sup. Ct., 773. It rests in the discretion of the court appointing the receiver whether the assets within its jurisdiction shall be distributed under its own direction or shall be transmitted to the primary receiver. U. S. *vs.* Coxe, 18 How., 105. It is eminently proper that claimants residing within its jurisdiction should be relieved from the expense and inconvenience of proving their claims in other jurisdictions, and that provision should be made for securing to them equality of distribution in respect to the whole assets of the corporation; but there is no hard and fast rule to control the discretion of the court in making such distribution of the assets as shall be just to all creditors, and ultimately effect a ratable distribution of all the property of the corporation."

In *Reynolds* vs. *Stockton*, 140 U. S., 254, this Court had occasion to consider the extent to which the court of

primary jurisdiction is bound by proceedings in other jurisdictions, to which ancillary receivers are made parties. Mr. Justice BREWER, delivering the opinion of this court, said (p. 272):

> "Where a receiver or administrator or other custodian of an estate is appointed by the courts of one State, the courts of that State re serve to themselves full and exclusive jurisdiction over the assets of the estate within the limits of the State. Whatever orders, judgments or decrees may be rendered by the courts of another State, in respect to so much of the estate as is within its limits, must be accepted as conclusive in the courts of primary administration; and whatever matters are by the courts of primary administration permitted to be litigated in the courts of another State, come within the same rule of conclusiveness. Beyond this, the proceedings of the courts of a State in which ancillary administration is held are not conclusive upon the administration in the courts of the State in which primary administration is had. And this rule is not changed, although a party whose estate is being administered by the courts of one State permits himself or itself to be made a party to the litigation in the other. Whatever may be the rule if jurisdiction is acquired by a court before administration proceedings are commenced, the moment they are commenced, and the estate is taken possession of by a tribunal of a State, that moment the party whose estate is thus taken possession of ceases to have power to bind the estate in a court of another State, either voluntarily or by submitting himself to the jurisdiction of the latter court."

In *Shinney* vs. *North American Savings, &c., Co*, 97 Fed. Rep., 9, it was held to be right for a federal court to appoint an ancillary receiver in aid of a suit instituted in a state court of another state. The learned Court said (p. 11):

> "It is admitted that when a receiver is appointed by a federal court, other federal courts, through comity, will usually appoint the same person as receiver of the assets within their jurisdiction; but it is argued that where the appointment is first made by a state court, federal courts are without power to act in conformity with the principle of comity.

No reason for such a distinction is apparent. The state court is of co-ordinate jurisdiction in such matters with the federal court sitting in the same locality. As between the parties, its determination of the insolvency of the corporation and of the need for a receiver is just as conclusive as if had in a federal court. The need for a uniform administration of the assets of an insolvent corporation inheres in the principles of equity, and does not vary with the forum first invoked. It is no unusual thing for a federal court to appoint an ancillary receiver of assets within its jurisdiction in aid of a primary appointment by a state court of another state."

In *Kirker* vs. *Owings*, 98 Fed. Rep., 499, the Circuit Court of Appeals for the Sixth Circuit considered the limitations upon the relation of comity existing between the court of primary jurisdiction and the courts exercising auxiliary jurisdiction, and held that such comity must yield before the duty of a court which authorizes receivers' certificates, to preserve a fund for their payment. The learned Court said (p. 511):

"Undoubtedly, it is necessary that in the management of large properties, extending through various districts, as a unit, there should be one court to determine the general policy thereof; and comity requires that all the other courts should yield on such matters to the opinion of the court of original jurisdiction. But this does not prevent each court, in respect of claims against a receiver which are purely local in their character, from protecting persons who, on the faith of the Court's credit, have advanced money or goods or rendered service to the trust. In such a case comity must yield to justice and right."

In *Coltrane* vs. *Templeton*, 106 Fed. Rep., 370, the learned Circuit Court of Appeals for the Fourth Circuit discussed the nature of these so-called "ancillary bills" and the necessity for entertaining them. The learned Court said (p. 374):

"The bill in this case is styled an 'ancillary bill.' Technically it is not an ancillary bill. The term 'ancillary bill' is applicable to a proceeding growing out of original proceedings in the same Court, dependent on

such proceedings, and instituted for the purpose of enforcing the judgment, or of rendering complete justice among all the parties in interest. Instances of a bill of this character can be found in Freeman *vs.* Howe, 24 How., 450, 16 L. Ed., 749; Railroad Co. *vs.* Chamberlain, 6 Wall., 748, 18 L. Ed., 859; Minnesota Co. *vs.* St. Paul Co., 2 Wall., 609, 17 L. Ed., 886; and Krippendorf *vs.* Hyde, 110 U. S., 276, 4 Sup. Ct., 27, 28, L. Ed., 145. It is more properly an auxiliary bill filed to assist another circuit court in the administration and distribution of assets in a cause properly before it. The circuit courts of the United States, by reason of the comity existing between them, entertain such bills, and give all the assistance in their power to the court in which the bill was filed originally."

And again on page 375:

"Corporations like the defendant at bar do business in many states, and their assets consist of mortgages, loans, and perhaps other property, in the states in which they do business. It is necessary for the purpose of collecting in their assets that proper parties to sue should be in existence. The receiver appointed in the Maryland district has no extra-territorial existence. Booth *vs.* Clark, 17 How., 322, 15 L. Ed. 164. It therefore becomes necessary that a receiver should be appointed in the districts in which these assets are, and to this end these auxiliary suits are filed. The circuit courts of the United States almost invariably (though there are exceptions) appoint the same receiver whom the court which first took jurisdiction appointed. This is from comity. It is not a matter of absolute right."

In *Lewis* vs. *American Naval Stores Co.*, 119 Fed. Rep., 391, Judge SHELBY passed on several important questions relating to the rights and powers of receivers, acting under an ancillary appointment, saying, among other things, at page 397:

"This procedure and practice of bringing auxiliary suits originated from the limitations imposed upon the territorial jurisdiction of the Circuit Courts, and from the fact that many railroads run into or through two or more states, constituting one property and one continuous line. 2 Bates, Fed. Eq. Proc., 617; Southern Ry. *vs.* Carnegie Steel Co., 176 U. S., 257, 20 Sup. Ct., 347, 44 L. Ed., 458; Farmers' Loan & Trust Co. *vs.* Northern Pac. Ry. (C.C.), 72 Fed., 26. While the

practice is especially applicable to such cases in which the title to real estate in different jurisdictions will be conveyed, it is applied also to cases involving the property of corporations engaged in business and owning property in different judicial districts and in different states. The courts in which the auxiliary suits are brought are entirely independent in fact of the court of primary jurisdiction. The end to be secured—the collection of all the assets of the corporation, and their uniform and equitable administration and distribution—moves the discretion of the Court to treat its jurisdiction as ancillary, and to aid in the collection of the assets, and to transmit them to the court of primary jurisdiction; and this course secures equality among creditors and stockholders and economy in the administration."

In *Conklin* vs. *United States Shipbuilding Co.*, 123 Fed. Rep., 913, Judge PUTNAM makes plain the distinction between that false comity which amounts to nothing more than indifference as to the possible rights of domestic creditors, and the true comity existing between the Federal courts, whereby they give each other intelligent aid in the administration of estates having a situs in a plurality of jurisdictions, while taking scrupulous care to preserve the rights of those who have the first claim upon their consideration, viz., the residents of their respective districts. The learned Judge said, in the course of an oral opinion (p. 915):

"The rule of so-called comity has little influence with me.

The best late writer on international law—Dicey—says very truly: 'The term "comity," as already pointed out, is open to the charge of implying that the Judge, when he applies foreign law to a particular case, does so as a matter of caprice or favor.' It is rather a scapegoat, an opportunity of escape for the Court. I know of few propositions that now come before the courts which are not governed by law, and in this case I must be governed by the law as practiced, and by the precedents, and not by any mere matter of comity. The law, as recognized in the Circuit Courts of the United States is that, when the Federal Court of jurisdiction at the domicile of the corporation appoints a receiver, or makes a decree

winding up a corporation and disposing of its assets, a decree of foreclosure, or any other decree looking to a disposition of its property, thereupon, assuming that to aid another federal court involves a federal question which will lawfully support the exercise of jurisdiction by the federal judiciary, the Circuit Courts in other circuits will exercise ancillary jurisdiction, and assist in carrying out the purpose of the court at the place of domicile."

These decisions afford an outline of a system of procedure which, while perhaps not complete or incapable of improvement, is far superior to that which this Court was urged to adopt in *Booth* vs. *Clark*. It is a system now universally understood. It works smoothly in practice. It effectively protects the rights of possible creditors in each jurisdiction where assets are found, by compelling the foreign receiver to give reasonable security and to submit himself to the orders of the local court before removing assets which may be needed to meet the claims of domestic creditors. It provides a convenient forum in which such creditors may prove their claims. It enables the receiver appointed by a foreign court, without delay or publicity or unreasonable expense, to qualify himself to collect or impound assets properly forming part of the estate under administration. It avoids unseemly conflicts of judicial authority. It provides a central tribunal for the determination of those questions of general policy which must be decided with reference to a great system of railways or a great business undertaking, while leaving to local tribunals full power over questions of a local nature. The courts of the several states and the legal profession throughout the United States are gradually conforming their practice to the standard thus established.

It is true that in state courts the system of ancillary

receiverships does not work as smoothly and easily as in the federal courts, for the reason that in the state courts the rules of procedure in equity are not uniform, and the principles applicable to the jurisdiction of courts of law and equity vary with state boundaries. Nevertheless, it may safely be said that even in New York, or New Jersey or Massachusetts, receivers appointed in other jurisdictions, having occasion to collect assets in those states by legal process, customarily obtain ancillary appointments before bringing suit in the state courts.

This practice is one which operates most favorably in the interest of those creditors whose claims are not of sufficient magnitude to make it worth while to prove them in a distant tribunal. It makes little difference to the creditor with a large claim, where he has to go to prove it. But the small creditors must get relief in their local courts or get none at all.

The petitioner has chosen to depart from the established and universal practice of federal courts in this regard, for no reason that has been or can be assigned, other than a desire to vary the monotony of equity practice in the District of Vermont. A system of procedure which has been carefully built up by the labors of federal judges in the last half-century, for the protection of the rights of small creditors, the petitioner now asks to have destroyed in order that he may be relieved of the consequences of his attempted innovation.

There can be no doubt that the exception contended for by the petitioner, if sanctioned by this Court, would destroy the whole system which now prevails for administering the affairs of insolvent corporations. However easy

it may be to obtain an appointment as ancillary receiver, it is still easier to use some one else's name as plaintiff in a suit. A receiver is not going to submit himself, unnecessarily, to the control of a court of the locality where he sues, when by slightly varying the phraseology of his bill he can absolve himself from such control.

It must not be forgotten that in the United States are many corporations which conduct their business at a distance from the states or territories by which they are created. All over the country are corporations organized under charters granted by Maine, New Jersey, Delaware, West Virginia, South Dakota and Arizona. When such a corporation encounters financial difficulties, a receiver is very naturally and properly appointed by the court of its domicile. Oftentimes the fact that an application for the appointment of receivers is impending is known only to the largest creditors. If the order appointing receivers could be so drawn as to bring about an immediate withdrawal of all the movable assets from the places where the corporate business has been conducted to the place of the corporation's domicile, great hardship would often result to those creditors least able to bear it. No argument or illustration is needed to show who would be hurt by such a procedure. And yet, on the theory proposed by the petitioner, such a result could not be avoided.

If the right to sue in the corporate name can be conferred on a receiver to take effect in a foreign jurisdiction, then the right to demand and receive possession of assets can likewise be conferred. The right to sue involves the right to collect the judgment; and the right to obtain

possession of assets by suit, for the purpose of removal from the State, implies the right and the duty on the part of the custodians of corporate property to make a voluntary delivery of such assets, for a like purpose.

But it is claimed that the right of the Court appointing the receiver to authorize him to sue in the name of a party is absolute, and does not rest on comity. Therefore, it is said, it is a right which must be recognized regardless of consequences. This view involves a radical misconception of the general powers of a court of equity, in regard to the appointment of receivers. A receiver may be appointed in a proper case for property and effects within the territorial jurisdiction of the Court. But the Court can no more invest the receiver with the name, identity and citizenship of a party for the purpose of suit in a foreign jurisdiction than it can confer on him a defendant's complexion, reputation, chirography or good health. Courts of equity have no such powers. As was said by this Court in *In re Sawyer*, 124 U. S.. 310:

> "The office and jurisdiction of a Court of equity, unless enlarged by express statute, are limited to the protection of rights of property."

Doubtless it will be argued that the Court has power to compel a party to assign a chose in action to a receiver, and also to direct the receiver to bring suit in a foreign jurisdiction on such assigned cause of action. Therefore, it will be said, the Court may accomplish the same result by an order directing the receiver to sue in the party's name without an assignment.

That argument appeared to this Court in *Booth* vs. *Clark* as one which cut both ways. It was considered in that case that the existence of a lawful method for reach-

ing assets in a foreign jurisdiction was an additional argument against the employment of an unlawful method (17 How., 339). If an assignment is made, it will have such effect only as is permitted by the laws and the public policy of the place where the assignment is to operate. If it is there deemed legally injurious to domestic creditors they can have their remedy in the ordinary course of judicial procedure to set it aside as in fraud of their rights. But such a remedy, invoked against an order of the Circuit Court of the United States, would be anomalous and most injurious to the dignity of the Court. A system of procedure which invites such attacks is not one to be commended.

It may further be said that inasmuch as the corporation might maintain the suit on the ground of diversity of citizenship, the defendant is not harmed if someone else sues in its name. That argument would be equally available in favor of any one who might choose to employ the corporate name for such a purpose, even though destitute of official authority. What if the corporation should afterwards choose to sue by a bill filed by its proper officers and authenticated by its corporate seal? Could the prior pendency of a suit begun by a receiver in the corporate name, with no better authority than an order of the Court of another jurisdiction, be successfully pleaded in abatement? Suppose, in this case, creditors residing in Vermont had obtained or were to obtain the appointment of a receiver of the property of The Great Western Mining and Manufacturing Company, situate in said district. Would the pendency of this suit, or any judgment obtained herein, be pleadable as a defense to a suit by such a Vermont receiver? Evidently not, unless the orders of

the Circuit Court for the District of Kentucky and the official acts of its receiver are to have an extra-territorial effect which does not belong to them under the decisions of this Court.

We have discussed the question of the receiver's right to maintain this bill in the form in which it was filed, because it is a question in the case and a part of the decision of the Circuit Court of Appeals; not because we desire to avoid a decision on the merits as to the alleged grievances set up in the bill. On the contrary, we should welcome such a decision; but we do not feel that the desire of these parties to have an adjudication upon the merits of their controversy ought to lead this Court into sanctioning a course of procedure which could not but be attended, for a long time to come, with the most mischievous consequences.

XVI.

The judgment of the Circuit Court of Appeals should be affirmed.

Dated April 5, 1905.

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